AMERICAN BANKERS ASSOCIATION JOURNAL

# A New Order of Bank Taxation

**The Spring Meeting of the Executive Council at Pinehurst Reviews the Activities of Organized Banking. Way to Fair and Equitable System of Bank Taxation Cleared. Crimes Against Banks Decrease. Council Asks Approval of French Debt.**

THE way has been cleared for a fair and more equitable system of bank taxation in the states through the action of Congress in passing legislation to permit states to tax the net income of National banks. The substitution of this system for the general property tax—the Executive Council of the American Bankers Association was informed by Thornton Cooke, Chairman of the State Taxation Committee, at the spring meeting held at Pinehurst, N. C., on May 3-4-5-6—would materially reduce the tax levies made on American banks and would place them more nearly on an equality with other business enterprises. It would promote the public interest by encouraging larger bank capitalization through eliminating the penalties now imposed by the general property tax and thus tend to give greater security to the funds of depositors.

The approval of this legislative proposal by the American Bankers Association led to its enactment at the present session of Congress and, according to Mr. Cooke's prophecy, has paved the way for "the coming revolution in bank taxation."

THIS report covered one of the most important activities of organized banking as recounted at this gathering of representative bankers from all of the forty-eight states, which reviewed the various steps taken and contemplated by the various agencies of the Association to improve the position of banking. The meeting was a cross section of what the Association is endeavoring to do.

The business of the Executive Council was dispatched in two sessions. President Oscar Wells stressed particularly the development of harmonious relations and efficient functioning of the Association's working organization. F. N. Shepherd, Executve Manager, said that "there has never been a time in recent history of the Association when its work was so distinctly characterized by a community of interest, a common purpose and a cheerful aggressive spirit." Recognition of this spirit was echoed in the various reports that were submitted by the heads of the Divisions and Sections.

THERE was only one resolution adopted. Reciting that "the Debt Funding Commission has fixed an amount it believes to be within the capacity of France to pay insofar as the intelligence of men can judge," the Council asked Congress "in approving this agreement, as we firmly believe it will and should, do so without political controversy and in such manner as to further the natural friendship that has existed between France and the United States since the beginning of our Republic and that will serve to stimulate peace, insure justice and increase trade for the moral and physical welfare of our respective peoples and those of all other nations."

The Council was informed of the steps taken by the General Counsel's office, in cooperation with the Committee on Federal Legislation, to promote the passage by Congress of three measures: The Revenue Bill of 1926; the bill amending Section 5219 of the U. S. Revised Statutes; and the McFadden bill, with Hull Amendments.

Encouraging progress in combatting crimes against banks is being made. James E. Baum, manager of the Protective Department, reported that the advance of organized banking against the criminal has been more rapid during the last six months than at any time since 1919. Crimes of violence during the first half of the Association's current fiscal year were cut to less than half of those reported for the corresponding period of last year; daylight robberies dropped from eighty-six to fifty-three and burglaries decreased 70 per cent. There has been a material reduction in the number of forgeries reported by member banks.

An analysis of the foreign debt settlements and their relation to reparation payments was made by Fred I. Kent, as Chairman of the Commerce and Marine Commission. He pointed out that the United States would receive $213,000,000 annually for the first five years and an average of about $365,000,000 for the next fifty-seven years, if all the settlements negotiated were approved and carried out. The extent to which these countries will be dependent upon the payment of reparations was indicated. After paying the United States and Great Britain, France

will have only $115,000,000 annually left out of the full time reparations, he calculated. Italy will have to devote practically all she receives from Germany in settlement of the allied debt, while Great Britain will be $30,000,000 short of the sum she has contracted to pay the United States even after she gets reparations from Germany and $60,000,000 annually under the French debt settlement, Mr. Kent estimated.

## The Division Highlights

DURING the Spring Meeting, sessions of the Executive Committees of the various divisions and sections were held to review the activities since the last annual convention and to plan the program for the future.

The State Bank Division reaffirmed its position on the McFadden bill, directing that all efforts be continued to have Congress pass the measure now pending with the so-called Hull amendments included to check the spread of branch banking.

The Trust Company Division adopted the recommendation of the special Committee on Taxation that the campaign to have the Federal Estate Tax repealed outright be continued. At the present session of Congress, this committee, in cooperation with General Counsel Paton, sought the repeal of the Federal Estate Tax, the gift tax, the provision taxing to the donor the income of a revocable trust and the publicity provision. Of these, the gift tax and the publicity provision were eliminated; the estate tax was retained, the maximum rate being reduced from 40 to 20 per cent and the reduction made retroactive and an 80 per cent credit for state taxes was allowed. The Division decided to continue its efforts to have the tax removed on the donor of a revocable trust and to seek the elimination of state inheritance taxes on intangible personal property of non-residents by the extension of the reciprocal arrangement between states or by outright elimination.

The National Bank Division discussed anew the proposal of the Treasury to change the size of the paper money and to simplify the currency, by reducing the variations in design. While endorsing the general purpose, the Division qualified its endorsement by insisting that only one size of currency shall be issued, that National bank circulation shall not be eliminated, that the distinctive marks now carried on National bank notes shall not be omitted and that National banks shall not be charged with the cost of producing new plates made necessary wholly by the desire of the Treasury Department to change the size of notes.

The Savings Bank Division approved the report dealing with the Building and Loan Association methods, which revealed that these associations in many states were conducting what amounts to a savings business without being subject to the reserve requirements and other regulations that are imposed on savings banks.

## The South's Strides

"THE Changing South" was the subject of the featured address at the "family dinner" of the Executive Council on Wednesday evening, delivered by Professor Edwin Mims, of Vanderbilt University. Dr. Mims dwelt upon the conflict between opposing ideas in the South and urged the people of other sections to lay emphasis on the signs of progress rather than on those of reaction, as this discrimination is necessary if an understanding is to be reached of what is really representative of the South today.

Describing the great development that has taken place in the textile industries in the Carolinas, the building up of a model industrial and social community in the Birmingham steel district, the surpassingly fine system of concrete state highways in North Carolina, the steady progress in educational advances in many states and the growing wealth of the Southern people, Dr. Mims said that "so often the stage seems all set for remarkable progress in public opinion and then something happens—such as the Dayton anti-evolution case—that swings us back into the old orbit of political and social immobility and decadence." The liberals of the South are quite as well aware of these paradoxes as anybody else, he said, but insist that people of the other sections should consider the acts of political and religious mountebanks and reactionaries for what they are worth and not think of them as truly representative of the thought and life of the South.

## Progress of the Association

IN making his report Mr. Wells said that the activities of the various units "and whatever they may accomplish or try to do will represent the progress of the Association and that constitutes the report of its Executive Officer."

"The Administrative Committee, to further the work of the Protective Department," he announced, "passed a resolution favoring enactment in every state of a law imposing severe penalties for robbery when the life of a person is endangered, the matter of adequate penalties, whether from fifty years to life imprisonment or not to exceed twenty-five years, being left to the General Counsel for determination after investigation, a bill to be drafted by him and urged by the Committee on State Legislation."

Mr. Wells reported that the Administrative Committee recommended an amendment of the Constitution to provide for membership upon the Committee of the executive heads of the American Institute of Banking, Clearing House and State Secretaries sections, and this was approved by the Council.

## Broader Extension of Service

IN the course of his report, F. N. Shepherd, Executive Manager, said: "The operating cost of the Association during the first seven months of the present fiscal year has been approximately $6,000 less per month than last year without any decrease in the efficiency of the organization. Although there has been a decrease in the number of the staff and in more than one instance work formerly in charge of two men is now handled by one, the result is increased efficiency, a broader extension of the Association's service and an improved esprit de corps throughout the entire organization. There has never been a time in recent history of the Association when its work was so distinctly characterized by a community of interest, a common purpose and a cheerful, aggressive, cooperative spirit. The conflicts between departments is today the wholesome rivalry of work well done."

## The Legal Department

THE General Counsel, Thomas B. Paton, in a review of the work of the Legal Department, touched upon many matters which have heretofore been told at length in this Journal. He outlined work relative to Federal legislation, especially in connection with the new revenue bill, the McFadden bill with the Hull amendments and the bill amending the section of the United States Statutes relating to state taxation of national banks. The Committee on Federal Legislation and the Special Committee of the Trust Company Division combined efforts for repeal of the estate and gift taxes in accordance with the resolution of the Atlantic City Convention he said, and the gift tax was repealed while the maximum rate of estate tax was reduced with an increase in credit for state inheritance taxes, the exemption was increased from $50,000 to $100,000 and the 1921 gift and estate tax rates were made retroactively applicable to the taxes under the 1924 law. The publicity provision was repealed and the tax on corporation capital eliminated, although there was a corresponding increase in the corporation income rates. Thus the Association obtained many of the results for which it worked.

A special feature of successful legislative work, he said, was in procuring amendments to section 5219 U. S. Revised Statutes permitting states to place national banks on an income tax basis on an equality with other business corporations. The amendments were worked out jointly by a special committee on taxation, the Committee on State Taxation and a Special Committee of the National Tax Association. The General Counsel also described in detail the extensive work of the Association on state legislation and laid particular emphasis upon the desirability of early enactment by the various states of the Uniform Fiduciaries Act in view of recent court decisions placing an impracticable duty of inquiry upon banks that give personal credit to agents, officers of corporations and other fiduciaries for checks made payable in an official or representative capacity. Lines of special work now in progress in his department he said, are revision of the credit forms of the Association and the procuring of information to show total amount of taxes paid by banks as compared with other classes of taxpayers in every state.

## Increase of the Institute

PRESIDENT BRUCE BAIRD of the American Institute of Banking said: "During the year we have organized sixteen new chapters and sixteen study groups. The total number of chapters today is one hundred and eighty-six, and of study groups, twenty-three. Total membership of the Institute is 57,451. Last October the Institute pledged itself for $25,000 for the American Bankers Association Educational endowment; $20,000 has already been turned over to the trustees, we have in hand $2500 and the other $2500 has been pledged."

Stephen I. Miller, Educational Director of the Institute, said: "During the past three years we have increased the enrollment in classes by 12,000, we have increased the number of graduates per year by 300, and we have brought the classes to a standard requirement of forty-two hours. We have added two textbooks to the Institute series, have revised three textbooks and have added two outlines.

"Through expansion of the educational program to the suburbs of banking there is opportunity to reach from two to three hundred smaller places by the group or round table study plan with an instructor, and that will be the development of the Institute during the years to come." He told of a plan to superimpose upon the present standard course a graduate course to give students an opportunity to go on with their work, especially along special lines, in investments, trusts, savings banks and credits.

## *Cooperation Through Clearing Houses*

ALEXANDER DUNBAR, President of the Clearing House Section, stressed the work of the Section in developing a national viewpoint and a spirit of cooperation among banks throughout the country. His report told of the work of the section in encouraging analysis of accounts by banks to determine losses and provide remedies, the promotion of check standardization, the organization of new clearing house associations and the installation of the clearing house examiner system, of credit bureaus in both cities and counties. He pointed out that twenty new clearing house associations, ten new city credit bureaus and seven new county credit bureaus were organized during the year.

W. C. WILKINSON, President of the National Bank Division, advised the Council of the protests filed with the United States Treasury against plans for a simplified currency by which bills would be made smaller in size and with fewer variations in design. The original plans contemplated making the general currency different in size from national bank notes. The Division insisted, President Wilkinson said, that only one size of currency be issued, that national bank currency shall not be eliminated, that the distinctive marks now carried on national bank notes shall not be omitted and that national banks shall not be charged with the cost of producing new plates which will be made necessary by the change in the size of the notes. But Mr. Wilkinson expressed the belief that a harmonious solution to this situation would be developed. A study has been made as to real estate loans by national banks. He said: "Real estate loans are demanding more attention in national banks. The Division made a tabulation of the nature and volume of such loans by national banks, showing the adverse effect of the restrictions carried in the present law. Studies were made to show the desirability of such loans and to caution also against exceeding the limitation set by law and by regulation and by sound judgment. Special attention was given to the practice of issuing participating trust notes against real estate securities. The plan has been found satisfactory for national banks when followed cautiously."

PRESIDENT Thomas F. Wallace of the Savings Bank Division said that a remarkable unanimity of opinion was developed at the three regional conferences as to the duties and responsibilities of the savings banks. He summarized these opinions as being to the effect that the duty of the savings banker goes beyond educating the public to save and should include educating them how to invest and escape unwise investments; that the abuse of installment buying especially for luxuries and non-essentials impedes savings; that cooperation should be extended to every thrift agency truly interested in the conservation of the savings of the country; that higher standards of competency should be required of those engaged in the banking business and that savings bankers should awaken to the danger to banks and depositors alike of allowing any other institution to receive savings deposits unless they are subject to the same laws and regulations that bankers have learned are absolutely necessary as a safeguard.

## *State Bank Division*

GRANT McPHERRIN, President of the State Bank Division, in the course of his report directed attention to the work of the Public Service Committee of his Division, under the direction of its chairman, M. H. Malott, to develop as a general practice that a financial statement shall be required of all borrowers having a line of credit of $500 or more. A statement on the subject had been submitted to the State Bank Commissioners and the replies indicated that a forward step in good banking would result. He said: "It has been said that the question of state guaranty of bank deposits appears to have passed into an eclipse so far as the extension of the idea is concerned. Let us not be deceived. I believe that this question will be constantly confronting us and it is the duty of every banker to occasionally drop a word of warning against this unsound banking law. Perhaps I am unduly alarmed, but living in Iowa at the present time, where certain politicians whom I consider unsound in principle, are making a house to house canvass urging the farmers to cast their vote for representatives and senators who favor the bank guaranty law, you can hardly blame me. This in itself is quite enough to alarm me or any sound-thinking banker. Let us, therefore, be on our guard and do all within our power to crush this dangerous and unsound idea."

## *State Secretaries*

EUGENE GUM, President of the State Secretaries Section, reported that the Section had adopted resolutions to the effect that since the vigilante, town guard, or ranger plan of protection has been effective in reducing bank losses in the states where it has been adopted, and some states in the Central States Conference have not yet installed such an organization, the conference should go on record as favoring the inauguration of the plan in all of the states where necessity or wisdom indicates. It was also decided that a Central States Protective Committee be appointed to amalgamate and standardize work of protection and give the widest publicity to all protective work in these states. The Committee is to investigate the feasibility of a standard bill for the creation of state bureaus of criminal investigation and identification and draw such a bill to be presented to the legislatures.

"If the section has majored in anything it has been in the suppression of bank robbery," Mr. Gum said. "A summary just compiled covering eight states in the Mississippi Valley reveals 850 bank burglaries in the past five years with an attendant loss of $516,755, and 397 robberies involving a loss of $2,185,782.45. Iowa had 143 burglaries and robberies during the same period with the loss of $380,624.80. The total losses from nine states involved in 1390 burglaries and robberies was $3,083,162.30. The total insurance carried by the banks of these states amounted to $304,044,328.70. We are urging more stringent laws dealing with criminals, quicker trials, longer term sentences, and fewer pardons and paroles. Seven states have organized vigilante committees to cope with the situation and other states are urged to organize where the increase in this crime is pronounced. In every instance the vigilante movement has decreased the crime wave very materially, and in some cases astonishingly."

## *Trust Company Division*

FRANCIS H. SISSON, President of the Trust Company Division, said in part: "The Trust Company Division is in the midst of one of its most active years of service. We are beginning to see in many directions tangible results of our activities, both past and present. The perennial so-called 'lawyers' bill' designed to prohibit trust companies from soliciting appointments as executor, etc., raised its head again in the Massachusetts and Rhode Island Legislatures but was effectively smothered The Committee on Cooperation with the Bar is at all times alert. The results of our educational efforts in this connection are showing in the reduced number of cases of unwise advertising by trust companies brought to our attention, and in the greatly decreased and almost eliminated unfriendly legislative activity on the part of members of the bar. The Committee on the Federal Reserve is continuing correspondence with non-member trust companies, ascertaining their reasons for not joining and sending them informative pamphlets published by the various Federal Reserve Banks.

"Trust companies," said Mr. Sisson, "have been in existence a little over one hundred years. Twenty-five years ago there were but 300 trust companies with total banking resources of $1,500,000,000. Today there are 2700 companies with resources of $18,000,000,000, showing a growth and development during this quarter century greater than that in all seventy-five preceding years. Through the work of the Trust Company Division, and the local trust company, information about trust service is constantly being disseminated throughout the entire country.

"The most gratifying feature of the last year's work has been the high degree of harmony and efficiency which has characterized the office activities both insofar

as they relate to its own and to the staff of the general Association in cooperation with them. I think perhaps we have reached the high water mark in this harmonious cooperation, which is always the ideal of efficient business, and I hope that that course toward a real business ideal may be pursued further during the years to come. It has been the hope and ideal of your present officers. Only by that sort of intelligent cooperation and shoulder touch, which unfortunately has not always characterized the work of the divisions in the years past, can the best results be assured."

## Banker-Farmer Cooperation

CHAIRMAN Burton M. Smith reported for the Agricultural Commission and told of banker-farmer conferences held throughout the country by which valuable suggestions as to cooperation were being carried from state to state. During the year, he said, forty-three conferences had been held in as many states and definite programs outlined for forty-two states. These conferences had been carried out in cooperation with state bankers associations, agricultural committees and agricultural colleges. For the purpose of getting in closer touch with agricultural problems the Commission has encouraged the holding of agricultural short courses for bankers and during the past sixteen months, these courses have been held in fifteen states and five others now have courses planned.

Marvin E. Holderness, Chairman of the Public Relations Commission, told of the American Bankers Association Journal and publicity. "The growing prestige of the magazine is being reflected in a most unmistakable way," he said. "The publicity work consists of two main elements. The first is distribution to the daily press and banking periodicals throughout the country of news covering the activities of organized banking as represented by the American Bankers Association. The other main activity of the Publicity Department is to supply articles of an informative nature to the country press with a view of increasing public understanding, confidence and patronage in banks in rural communities. The Commission was created by action of the Washington convention of 1920. We feel that in the six and a half years of its life the Commission has fully justified its existence. The aims have been to disseminate true information about the working and services of banking; to increase the utilization of banking services of all kinds on the part of the general public; to educate the public in proper ways to carry on their banking relations such as the correct handling of checks, the maintenance of adequate bank balances, and so on; to inculcate a spirit of thrift and wider use of savings banks and to warn banks and the public against the operation of crooks and render their fraudulent activities more difficult through exposing their methods."

## The Educational Foundation

JOHN H. PUELICHER, Chairman of the Educational Foundation Trustees, announced that there had been pledged up to the present time $500,875, and paid in $227,645.19. There are also signed pledges easily collectible at any time of $56,333.34. By this, and the balance of the pledges from the American Bankers Association and the American Institute of Banking, the cash receipts amounting to $227,645.19 may be augmented safely to a total of $315,604.37, he said and added:

"It is considerably easier to raise money than to give it away intelligently. We are, therefore, proceeding very slowly and carefully. We have given consideration to the problem of how to invest the funds. We have given the scholarship problem a great deal of thought. We have been in touch with professional educators in practically every college of the country. The consensus of opinion has been that we should not have a great number of gift scholarships.

## The Second Session

PRESIDENT WELLS, on the second day of the Executive Council meeting, commented on the development of harmonious relations and efficient functioning that has been attained throughout the Association's working organization.

"The success of the Council meeting reflects the fact which was related a number of times in the reports presented that perhaps at no time previous in the history of the Association have all of its functions been going forward with as much earnestness, with as great a desire upon the part of the separate departments for cooperation," Mr. Wells said. "It has been very gratifying to me and to the officers and especially to the staff officers in the New York headquarters that every separate, organized constituent part, as represented by the Divisions, by the Sections, by the Commissions and by the Committees, has been working so thoroughly in accord and seemingly with great interest in the respective objectives.

"The Council meeting is designed for the purpose of bringing members of the Council, representatives of the American Bankers Association as they are, chosen by the members of the Association in the forty-eight states, together that they may get a cross section of what the Association is attempting to do. In no other way could you understand so clearly the various activities because the ramifications of the Association's work are quite extensive. It gives you a more familiar picture of its endeavors and, therefore, places upon your shoulders the greater responsibility of doing whatever you can whenever you can to further those interests, if you agree with them, and gives to you also an opportunity to register an objection if, in your judgment, the Association's efforts are not along proper lines."

## Insurance Coverage Broadened

IN presenting his report, Frank Keyser, Chairman of the Insurance Committee, said in part: "Your Committee is very much gratified with the reception that continues to be accorded the American Bankers Association copyrighted forms of fidelity, bond and burglary and robbery policy by member banks and underwriters alike. No cases have been presented in which there appeared any demand from members for change in these forms. Section (5) of Condition B of the 1925 form of burglary and robbery policy, as originally copyrighted, relieved the underwriter of liability for loss or damage from or contributed to by riot, strike, water, or the action of the elements. This Committee's report to the Executive Council last September related the fact that the governing committee of the National Bureau of Casualty and Surety Underwriters had recommended to the Bureau that the restriction pertaining to loss from riot, strike, water, or the action of the elements be deleted from the policy. Since the sole effect of the proposed amendment was to broaden the coverage, your Committee agreed to the change, which has been approved by the Bureau and is now in effect." He told of work under way to work out a form of bankers' blanket bond.

Fred I. Kent, Chairman of the Commerce and Marine Commission, said that a survey had been made of commercial aviation as it is carried on in a number of European countries, and it was found to be so valuable that the Commission passed a resolution recommending that Congress establish a legal status for commercial aviation in this country when it is felt that we can develop it more rapidly.

He presented a detailed statement concerning the debt settlements made by the Debt Funding Commission with the United States and discussed the relation of reparation payments to this international question. At the conclusion of his report, he offered a resolution drafted by the Economic Policy Commission urging Congress to approve the agreement negotiated with France "without political controversy."

On motion from the floor, this resolution was adopted by unanimous vote as action of the Executive Council.

## Federal Legislation Report

THE report of the Federal Legislative Committee presented by General Counsel Paton for Chairman Max B. Nahm said that approximately four hundred bills and resolutions have been introduced in the first session of the Sixty-ninth Congress directly or indirectly affecting banking.

"It is the duty of your Committee," the report said, "carefully to weigh the effect of each bill and, ever alert, give aid only to those which are to your interest and that of the people, and to discountenance the passage of such as are inimical to banking in any form." The report gave the details of work to urge the elimination from the Revenue law of the Federal Estate and Gift Tax and to procure repeal of the capital stock tax, a reduction of the tax on corporation incomes in keeping with the tax on individual incomes and the repeal of the publicity provision. All these matters were urged at hearings before the House Ways and Means Committee. The Committee was also active in promoting the McFadden bill with the Hull Amendments in pursuance of the mandate of the Chicago Convention.

H. Y. Lemon, in presenting the report of the Membership Committee, said: "The Membership Committee is of the opinion that there should be some one man in each state given the authority and charged with the responsibility of keeping up the membership in his state, and recommends an amendment to the constitution that it shall be the duty of the State Vice-Presidents to enforce

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# A National Policy for Preventing Sale of Fraudulent Securities

By A. W. MELLON
Secretary of the Treasury

**Pressing Need of a Statute Which Will Repress the Flow of Worthless Securities Through the Channels of Commerce Among the States. Campaign of Education Would Accomplish Much. One Bill Pending Would Unreasonably Restrict Business.**

ONE of the important problems confronting this country is the prevention of the sale of fraudulent securities. The state governments are doing what they can to combat this evil. They have enacted a number and variety of statutes, which range all the way from Blue Sky Laws to Fraud Acts; and in many states these laws are proving effective in regulating either the kind of securities issued or the character of those who sell them. The Federal government itself is exercising the full power of its regulatory organizations, and by means of the power vested in the Post Office Department is able to lessen the perpetration of frauds through the mails.

In spite of all the efforts which have been made, more than half a billion dollars, it is estimated, are lost each year, largely by small investors. One of the serious aspects of the situation is that, in many instances, this waste of hard-earned capital could have been prevented if the investing public had been impressed with the necessity for investigating the security or asking the opinion of some competent adviser before risking their savings in questionable investments.

It is for this reason that the Treasury Department is interested in the movement now being carried on by many bankers and publications to inform the public of the obvious pitfalls which threaten investors. Much can be accomplished by such a campaign of education, and perhaps, in the end, the real solution of the fraudulent security problem depends on the success of such a campaign. But all processes of education are necessarily slow and each year a very appreciable amount of capital is being lost, so that it would seem to be the duty of the Federal government, no less than of the state governments, to provide adequate legal machinery for protecting the public against unscrupulous dealers.

## What Form?

*IT has been suggested that the situation could be met most simply and adequately by a law under which such securities as appear to be fraudulent could be brought to the attention of the United States Department of Justice through proceedings in the nature of an information. The Attorney General could then be authorized to investigate such securities and, if he found evidence of fraud, to issue a summary order, forbidding their further sale under heavy penalties.—*
A. W. MELLON.

## *Would Restrict Transactions*

THERE is a growing sentiment in favor of such a policy on the part of the national government, as is evidenced by several bills which have been introduced in Congress. One of these bills (H. R. 52), undertakes to prohibit the use of the United States mails or any agencies of interstate or foreign commerce for the transmission of securities for sale to any person in any other state in which it is at that time unlawful to sell or solicit subscriptions for such security. It also seeks to prevent the use of the mails or any agencies of interstate or foreign commerce for the transmission of letters and circulars tendering for sale or soliciting orders for, or procuring advertisements for the sale of, securities when addressed or consigned to any person at any place in any other state, territory, or district of the United States in which it is at that time unlawful to sell, offer for sale or solicit subscriptions for such security. It provides that any person violating any of the provisions of this Act shall, upon conviction, be punished by way of fine or imprisonment, or both. The bill exempts from its operation several important classes of securities and business transactions, involving the sale or disposition of securities, and provides for the exemption of certain bonds and notes secured by mortgages on agricultural lands and other real estate.

Notwithstanding the exemptions proposed, such a bill would unreasonably restrict transactions in securities and would involve innumerable difficulties of interpretation and administration. It would, in effect, subject all transactions, conducted through the agencies of interstate commerce, in stocks and other securities to the Blue Sky and Fraud Laws of the various states; and it would place upon the Federal government almost insuperable difficulties in enforcing these diverse laws, many of which create purely technical offenses. Their enforcement would not only cause frequent embarrassment in legitimate transactions, but would result in hardship and injustice, if a uniform penalty was imposed without regard to the offense prohibited by any particular state law.

## *Too Complicated*

THE number and variety of exemptions that must be made, in order not to place too great a burden on legitimate business transactions, illustrate the difficulty of regulating issues of securities by rigid requirements which apply to all cases alike. In addition to the difficulties of administering such a law, the numerous exemptions are necessarily so complicated that to master their application would impose a heavy task upon all those who deal in securities.

The proposed law has the further disadvantage both of tacitly approving all dealings in securities in the exempt list, regardless of how undesirable such dealings may be, and also of unduly restricting many legitimate financial operations which may fall outside the exempt classification. Furthermore, such a law, imposing upon the Federal government the duty of enforcing state laws, might not only establish an undesirable precedent, but would subject the national government to very great expense in organizing and maintaining the machinery necessary for the enforcement of the many laws on this subject passed by the states.

In spite of the objections which may be raised to this particular form of legislation, there is a pressing need for a Federal statute of some sort, which will repress the flow of issues of fraudulent or worthless securities through the channels of commerce among the states without putting an undue burden on legitimate issues. The state laws are doing much to improve the situation. But they are not entirely adequate and, at

the same time, they are more diverse and burdensome than a comprehensive Federal statute would be. Without attempting to interfere in any way with the work which the various state commissioners are doing, it would seem that the situation is essentially one which should be dealt with by Congress through a law applicable to fraudulent transactions and issues of securities employing interstate agencies. Such a law should provide effective safeguards for protecting the public against fraudulent promotions which are now responsible for so great a waste of capital.

### *Without Harassing Business*

WHAT form should such legislation take? It has been suggested that the situation could be met most simply and adequately by a law under which such securities as appear to be fraudulent could be brought to the attention of the United States Department of Justice through proceedings in the nature of an information. The Attorney General could then be authorized to investigate such securities and, if he found evidence of fraud, to issue a summary order, forbidding their further sale under heavy penalties.

Such a law would not interfere with the flow of legitimate investments or the prompt sale of securities which is so essential in the investment business. It must be remembered that the great majority of investment bankers are honest and scrupulous men who investigate with extreme care every issue of securities sponsored by them. Only a small number are actuated by a desire to defraud, and, in trying to protect the public against such unscrupulous dealers, we must be careful not to harass and interfere too much with legitimate operations.

The investment banker plays an important part in the country's development. It is through him that capital is largely obtained for schoolhouses, waterworks, irrigation, electric light, and a multitude of projects and industries so necessary to the progress of the country. In most instances, he is deserving of the confidence which is placed in him, and it is for his protection, as well as for the safety of the investing public, that a sound national policy should be established whereby the sale of fraudulent securities can be prevented.

# Bonds to Share In Profits

By W. A. LLOYD

THERE are seasons for everything—even for securities. We have had a protracted, sunshiny season of stock speculation. That is over. We may now be entering a cloudy period with considerable unsettlement. Less is being said of the relative merits of common stocks and long term bonds. The one group has had its best days for a time, while the other seems to be gaining in popularity. The point that the writer wishes to try and make clear in this article is the permanency of common stock investments and the growing demand on the part of the investor for more participation in the equities or earnings of corporations for which his capital is sought.

The old fashioned investor chiefly bought bonds. These were mortgages on properties and he became a creditor when he purchased them. With the falling value of the dollar and the rising cost of living, the bond-holder was between the upper and the nether millstone, and, coming into a period of great industrial prosperity, he witnessed the profits to the common stockholder as he saw the return on his supposedly better investments all the while shrinking in purchasing power. This created the psychology on which the students of investments worked to such a great advantage in 1924 and throughout 1925, establishing a theory of common stock investment which, while having lost some cast lately, will undoubtedly continue to divert from the channels of investment for many years to come. There is no question but that the possessor of capital feels he should have greater return on this capital and that, even though he may be a bondholder or creditor, there should be some opportunity given him to possess a portion of the excess earnings of the company in which he has placed his funds.

IF the past generation bought bonds for investment almost exclusively, it may be said that the generation which controlled the securities markets of the past two years were equally exclusive in their buying of common stocks. What we shall probably see in the next few years will be the bringing together by these two investment schools of a better general investment balance, so that the portfolio of the modern investor will not only contain a considerable percentage of bonds but a good sprinkling of the common stocks of our best managed railroads, public utilities and industrial corporations. In determining the proper proportions of the investment account of a bank, it is considered advisable for the institution to hold say, 40 per cent in railroad bonds, 35 per cent in public utility bonds, 15 per cent in industrial bonds and 10 per cent in foreign government, municipal and industrial bonds. From year to year, it would seem as though the individual investor might balance his investment account in the proportions of 60 per cent long term bonds and 40 per cent common stocks, their percentage however, varying with market conditions. At the present time, for instance, he would be much better off were he to increase his bond account to 75 per cent of the whole and reduce his common stock account to 25 per cent, for there is appreciation in sight in the one and depreciation in the other. Following a long period of industrial depression, he might again change the proportions and with discrimination raise his common stock account to 60 per cent and reduce his bond ratio to 40 per cent.

FUTURE financing by corporations must give heed to the new idea in investing which demands a larger portion of profits and allows the purchaser of new bonds "some run for his money." We see instances of this every day in "set-ups" in bond circulars where, attached to the bond are warrants for common stock, or convertible privileges into common stock. This insures the buyer of the bond of the option, after a certain period, of exchanging his bond for a stock, thereby increasing his income and principal, though reducing his position from creditor to possible debtor. There are other evidences of the same demand in financing that provide convertibility for bonds into preferred stocks and for the exchange of preferred stocks for common stocks, as the preferred shareholder is in relatively the same position as the bondholder in the matter of fixed income but without being a creditor. Some corporations have gone even further than this and have agreed to increase the rate of interest on their bonds at such time as the dividend on their common stock has exceeded a given rate.

This process of equalization will go on more and more, and it seems to be the only way by which the investor, who first of all desires safety of his principal, can meet the seasons of low earning power of the dollar invested. The times when bonds are high in price are when money rates are easy, business is dull and earnings on common stocks are, in consequence, low. Conversely, when money rates are high, when business is active, then earnings on common stocks are at their peak. Now, if to the holder of the fixed interest return obligation is given some form of participation in corporation revenues, he will be satisfied. The loss in the buying power of every dollar he receives in interest on his bonds will be compensated by that portion of another dollar which he will receive as participant in the seasonal earnings on his ratio of common stock. This gets as near to the idea of the stabilized bond as it is practical to go.

## Uniform Letter of Credit

IN 1920 and 1921 the banks of the United States, issuing letters of credit, lost large sums of money, partly because of the difference in phraseology in letters of credit, and the difference in the interpretation of some of the phrases in the letters of credit.

The Commerce and Marine Commission passed a resolution recommending that a study be made of this matter, and a uniform commercial letter of credit, insofar as the skeleton is concerned, be prepared, and that certain common phrases be given common interpretation. That resolution was sent to the International Chamber of Commerce meeting in March of this year and presented to the members of the Chamber from 36 countries. They are studying it now and expect to make a report at the meeting to be held in Paris in June.

# The United States as a World Money Center

By CHARLES H. SABIN
Chairman of the Board, Guaranty Trust Company, New York

**Commanding Position in International Finance Gained Without Seeking It. America Largest Exporter of Capital. Fills New Rôle in Supporting Foreign Currencies. Development of Bill Market Makes New York Investment Center for World's Surplus Funds.**

WITHOUT seeking primacy in international finance, the New York money market has acquired a commanding position—partly as the result of the rapid development of wealth in the United States, partly as the result of our increasing investments and the unparalleled influx of gold, partly as the result of the changed position of capital exporting countries and partly as the outgrowth of changes in our banking system, which permitted the creation of an acceptance and discount market and sanctioned the establishment of branch banks in foreign countries.

The New York money market is in reality the money market of all America because it is the point through which all sections of the nation have contact with the world financial centers.

### *Our Growing Eminence*

THE headway that the United States has made toward becoming a world money center has been impressive and the position attained more important than is generally appreciated. New York owes its high position more to conditions over which it had slight, if any, control than to any conscious efforts to serve in this capacity by the comprehensive development of facilities; but, even before 1914 we had made a start and it was quite evident that the United States would play an increasingly important part in international finance as well as that the scope of its influence would be extended with the passing of time. The war and the conditions that followed in its wake hastened the movement.

As one of the changes wrought by the war, the level of our interest rates has been lower than those of the European centers. This is a reversal of the situation that obtained prior to that time when capital could be procured more cheaply in the foreign money markets than in the United States. In recent years our wealth has been so prodigious that we have had enough to supply our own needs and yet lend capital abroad, where it has been in urgent demand. Borrowers have followed the traditional policy of seeking funds in the cheapest market so they naturally have turned to the United States. Thus, we have achieved a commanding position more as a beneficiary of circumstance than as a deliberate seeker of financial pre-eminence.

### New Financing

*NEW YORK has become recognized as one of the two most important world money centers. In this article, Mr. Sabin indicates our growing importance by telling of the use of American bank credit to finance foreign trade between two outside countries, the investment of foreign bank balances in securities in the New York money market, the extension of loans by American institutions to support the currencies of other nations—financing that was rarely done here prior to the World War.*

In appraising the strides that the United States has made in serving as banker to the world, it obviously will be necessary to compare our totals in foreign trade and finance with those of England. Therefore, I think that it might be well to state at the outset that I do not conceive of New York as displacing London as the financial center. The present financial problems of the world in the rehabilitation of trade and the stabilization of exchange have become so vast that more than one center is necessary to carry on the work in a satisfactory way. New York is cooperating with and supplementing London in this vast task.

### *Largest Exporter of Capital*

BY virtue of our tremendous resources, our huge accumulation of wealth and the vast hoard of gold that came to our shores, we have become the world's largest capital exporting nation. During the past two years, foreign loans amounting to more than two billion dollars have been offered and absorbed in the United States. The extension of these loans has been achieved without restricting the supply of credit to our domestic interests and it would appear that we can continue to lend vast sums annually, if ability to loan were the only consideration. Foreign loans floated in the New York market during this period far exceeded those issued in England, but it must be remembered that Great Britain returned to the gold standard in May, 1925, and, as a means of protecting her gold reserves, was constrained to place restrictions for several months on the flotation of foreign loans. While our country has taken the rôle of the largest exporter of capital, sight should not be lost of the fact that this was done during a time of abnormal conditions when sources to which borrowers normally had turned for years past were more or less closed.

The commercial banking power of the United States, as measured by assets, is more than three times as great as that of any other nation. We have, far and away, the greatest stock of monetary gold—nearly half of the whole supply. A debtor nation before the war, we have become one of the two greatest creditor nations. American investments abroad, which were estimated to be around two billion dollars in 1914, have grown until we have a stake of about 10½ billions in other countries, excluding the debt of the Allies to the government. Great Britain bore the brunt of financing the costliest war in the annals of history and, as a part of her sacrifice, was forced to sell a huge amount of her foreign securities to get the funds to sustain her effort at arms. The British investment in foreign countries is now less than it was in pre-war days but it is still materially more than ours. However, we may attribute a large part of our commanding position in international finance to our increasing investment.

### *Filling a New Rôle*

IN one respect, the United States has been called on to assume an important rôle in world finance filled by England in other days.

Having had a free market for gold, England, for many years, supported the currencies of other nations in time of stress by

keeping her own currency sound and by extending credits in various forms to the central banks and to other responsible agencies when needed. It may be recalled how in 1893, London made available large amounts in gold to help us maintain our money on a gold basis. Credits of more than a half billion dollars, arranged through private bankers and the Federal Reserve banks, have been made available in recent years by the United States so that the currencies of Great Britain, France, Italy, Denmark, Finland, Belgium, Czechoslovakia and Argentina might be stabilized, or monetary conditions improved.

While it would require volumes to describe the various factors that entered into the creation and maintenance of London as the world's financial center, it is probable that the strict maintenance of a sound currency based on gold and a highly developed banking system with a large and elastic money market where funds could be readily invested for short terms with little or no risk were the greatest factors in its pre-eminence. The pound sterling became the common denominator of trade, and a great part of international trade—even transactions between two outside foreign countries —was financed in bills of exchange drawn on London, where they could be readily discounted. The existence of the bill market meant that the exporter of nearly any country might receive cash for his goods as soon as he shipped them. London attracted the world's surplus funds and large balances were kept on deposit there to facilitate the settlement of business transactions. Throughout the world, there was always a demand for sterling bills.

Many of the currencies of other nations were based on sterling, so a change in rates of the Bank of England or a movement in its reserves were felt in every commercial and financial center. A credit in sterling could be turned into the money of almost any nation without difficulty.

## The American Bill Market

THE establishment of the Federal Reserve System not only gave the United States a scientific, elastic currency and made possible the mobilization of its gold reserves but opened the way for the development of a large discount market here by granting the right to banks to accept drafts drawn on them, thus creating the acceptance market and enabling the rest of the world to draw on our surplus credit to finance the movement of goods. Another short-term prime security, which has high favor as an instrument for the investment of surplus funds, has been added in Treasury certificates of indebtedness, which have been issued in large volume in recent years in connection with the temporary financing requirements of the government.

The extent to which the banker's acceptance is being employed in our foreign trade is indicated by the estimate of the American Acceptance Council that an average of more than three billion dollars in imports and exports annually is now being financed by this instrument, the creation of which has done more than any one other change in banking practice to make our money market international in character.

How largely the principal commodities entering into our vast foreign trade are being financed by acceptances was revealed pointedly by the Federal Reserve Board's annual report. The outright purchases by the Reserve banks alone of bills drawn to finance imports and exports amounted to more than $1,150,000,000. The financing of nearly a third of the total imports of silk, coffee, sugar and wool and nearly a fourth of the total exports of cotton, grain, copper, lard and meat was covered by the acceptances acquired by the twelve regional banks.

Before the outbreak of the war, it was estimated that about 325 million pounds sterling—about $1,500,000,000 in bankers' bills—were currently outstanding in London, but the amount of bills offered since the war probably has been less. On January 30, 1926, American bankers' acceptances amounting to $788,253,933 were outstanding. It is interesting to note that American bank credit is being used to finance trade between two outside foreign countries, something that was rarely done in pre-war times.

While it cannot be said that the New York discount market has yet developed to the point where it is strictly comparable with the London bill market, impressive headway has been made within a few years and certain events have indicated that the bankers of other nations recognize the United States as a new center for the investment of funds. The largest foreign commercial banks and important corporations maintain larger balances than they ever have before and some of the foreign banks of issue regularly carry a portion of their surplus funds in our market. There does not appear to be a record of this ever having been done in pre-war days.

## American Banks Abroad

WITH the passage of the Federal Reserve Act, American national banks were authorized to establish branches in foreign countries. State banking institutions had long enjoyed that privilege though only a few had exercised it. The Guaranty Trust Company of New York was the pioneer in this field and established an important branch office in London as early as 1897. Several state chartered corporations organized for international banking were spreading their influence over the foreign field slowly prior to the war. While some of the branches that were set up during the post-war boom have been discontinued, a network of about one hundred American banking offices in various parts of the world remains.

The machinery required for the financing of world trade is most intricate. The experience, intelligence and skill that the bankers must have to keep posted on conditions and requirements of trade everywhere cannot be acquired overnight, or within a few years. It is quite apparent that highly trained specialists are needed for the conduct of the business and, quite frankly, it is this lack of seasoned, qualified bankers, in international trade and finance that is the greatest handicap the New York money market has to overcome in living up to the great responsibilities that it is assuming. In due time, this deficiency surely will be overcome and there is ample assurance that the United States will become increasingly important as a world money center.

In reviewing the developments of the past few years, one cannot help but be impressed by the progress that has been made. Our old, imperfect banking system that suffered periodical breakdowns, has been replaced by the Federal Reserve System that has proved itself capable of withstanding the severest of strains and has been pronounced by the world's most competent bankers as being well suited to accommodate our domestic and foreign business requirements. We have created the banker's acceptance and developed a discount market to which the world is already turning for the investment of its surplus funds. The dollar acceptance has become widely known as a satisfactory part of the currency in international trade. Through the Federal Reserve banks, we have widened our contacts and relations with the most important foreign banks of issue and thus made it more possible for this country to exert more influence than hitherto in the movement of funds between world markets. The chain of one hundred branch banks in foreign countries and a steadily increasing investment that now exceeds 10½ billions of dollars indicate the important place that America now occupies in the world of finance and gives an idea of the heavy responsibility resting upon this country in connection with its new international position.

## Gold Flows In

COMPLETE figures on gold imports into and exports from the United States indicate net imports of $39,200,000 for the month of March, the largest monthly import balance since May, 1924. The net inflow during the first quarter of 1926 totaled $77,000,000 compared with a net export of $133,000,000 in the first quarter of 1925. Actual imports in March were $43,400,000 and included consignments from Canada amounting to $39,300,000, and $2,500,000 from Chile. Exports were $4,200,000, chiefly to Hong Kong, British Malaya and Mexico.

# The Human Side of Banking

By IRVIN S. COBB

**Famous Wit Suggests Reform in Interior Arrangement of Bank To Include First Aid Station for Disappointed Loan Seekers. "No" Should Replace "Loans" as Designation Over This Window. Trade Secret of a Wall Street Man. The Country Banker.**

AT the very outset of this gathering, I suffered a grievous disappointment. I had every expectation that these proceedings would be opened by the singing of the national anthem of your profession, "If you ain't got no money, you needn't come around." It is a lamentable characteristic of nearly all speakers that immediately upon getting up on their feet, and reaching under the tails of the customary frock coat, where the seat of oratory is found, they should be reminded of a story, and, by an incredible coincidence I, rising before you, am reminded of a story which I trust has a more or less direct bearing upon the informal remarks of the men who shall follow.

The story had to do with a colored man who, in my native state of Kentucky, was arraigned in the criminal court on an indictment charging mayhem and, as Exhibit 1 for the Government or prosecution, the mutilated victim of his wrath was presented before the jury's eye, and the face of the victim was but little more than a recess—a place where a face once had been but was no longer. When the jury very promptly and properly had come in with a verdit of "guilty," his Honor, on the bench, addressing the convicted prisoner at the bar, and pointing to what was left of the unfortunate who had suffered at his hands, said: "In a long experience on the bench, this is the most lamentable case of human brutality that it has ever been my misfortune to look upon. Surely, surely, no man, unless he was actuated by a malign influence, could have deliberately worked such havoc as you have worked on the face of a human being. The demons from Hell must have inspired you in what you have done. The devil himself must have urged you on to this gory and heinous climax. Have you anything to say before the sentence of the law is pronounced?"

And the defendant said, "Yes, I have. Judge, your Honor, as I look back on it, I ain't sure but what you are right. It seems to me now like, when I was cutting his nose loose from his face with a razor, the devil was right behind me, saying, 'That's right, separate him from his nose.' And I expect it must have been the old demon, you speaks of, that suggested stamping out his front teeth. But, Judge, biting off his ears was strictly my own idea."

Now, assigning to me a definite topic under the heading, "Are Bankers Human Beings?" was an idea which originated with your Committee on Arrangements, and which opened up too vast a field of scientific and biological speculation for a mere amateur to undertake a diagnosis. So I, with your permission, shall depart ad libitum from that topic. Assigning to me a certain subject to speak about was a notion conceived in the fertile mind, I think, of your President. Departing from it will be strictly my own idea.

*IRVIN S. COBB, famed as a wit and a story teller, recently appeared before the Louisiana Bankers Association and regaled the bankers with a collection of amusing stories that touched upon the human side of banking. Incidentally Mr. Cobb suggested that there should be a slight change in the signs appearing over some of the banking windows. Where now appear the roman letters "Receiving Teller," he proposes that "Yes" would be more appropriate. He proposes that "Loans" be replaced by the more simple—but according to his ideas—more indicative word "No."*

## Cobb Suggests Reform

IT ill becomes one of the debtor class, I think, to undertake to delve into the higher mysteries of that peculiar calling which we sometimes call banking and sometimes by a stronger name. If I were going to suggest any reforms, not in the internal economies of your craft, but merely in the physical adornment of your counting houses, I would suggest, first, that there be installed in a prominent place leading outward, for the benefit of your customers, in each instance, a first aid package to check bleeding. Secondly, that those two steel coated wickets or windows now marked in Roman letters with the words "Receiving Teller" and "Loans" should be changed so that two infinitely more appropriate and certainly more truthful words of our language might there appear, to wit: "Yes" and "No."

Far be it from me myself ever to meddle, amateur that I am, before the altar of the high priests of finance. My attitude religiously shall be that of the Jewish gentleman from my present abiding place, New York, who is said to have opened a room to sell hot wienerwursts in the shadow of the National City Bank.

## The Trade Secret

THIS Hebrew gentleman obtained this remarkable concession of selling frankfurters almost at the very portals of the National City Bank and the clerks from the various institutions in that part of Wall Street flocked to his establishment, and his business grew apace. At the end of about one week, a friend called on him and found that he had three of his sons serving frankfurters, and his wife was cooking while he, like a true executive, simply cast a managing eye over the operations.

His friend inquired, "You are doing well here?"

He said, "Well, I am. Yesterday we sold frankfurters $280 worth. Today we will sell $300. Saturday I pulled down over $500. That is something enormous, this business."

His friend said, "You do well, eh? Maybe you loan it to me $100 to buy merchandise?"

He said, "No."

The friend said, "Ain't we friends?"

"Sure, sure, we are friends from way back—always friends."

"You are making big profits here, and you won't lend me $100—lend me for two weeks only 100 measly dollars?"

The frankfurter man replied, "Listen, I tell you a trade secret. We got an arrangement here. I don't lend no money and the National City Bank don't sell no wienerwursts."

## More Than Material Wealth

I SUPPOSE it is apropos to speak, in a bankers' convention, of wealth, but since I belong to a profession which is content largely to cull the artistic flowers in the garden of life and leave to you the mere dross of dollars and cents, I am struck by the fact that there is a spiritual wealth greater sometimes than the material, and it does not take the mere possessing of a bank account to guarantee it.

For example, on one occasion on a cold, bleak, dark, gray November morn, two homeless, ragged, penniless, empty-bellied derelicts were drifting down the Bowery, wondering where they would get their next

meal, if any. On the sidewalk in front of them they spied lying there a little tube of pills containing cocaine, which had been dropped by some habitué in the use of cocaine.

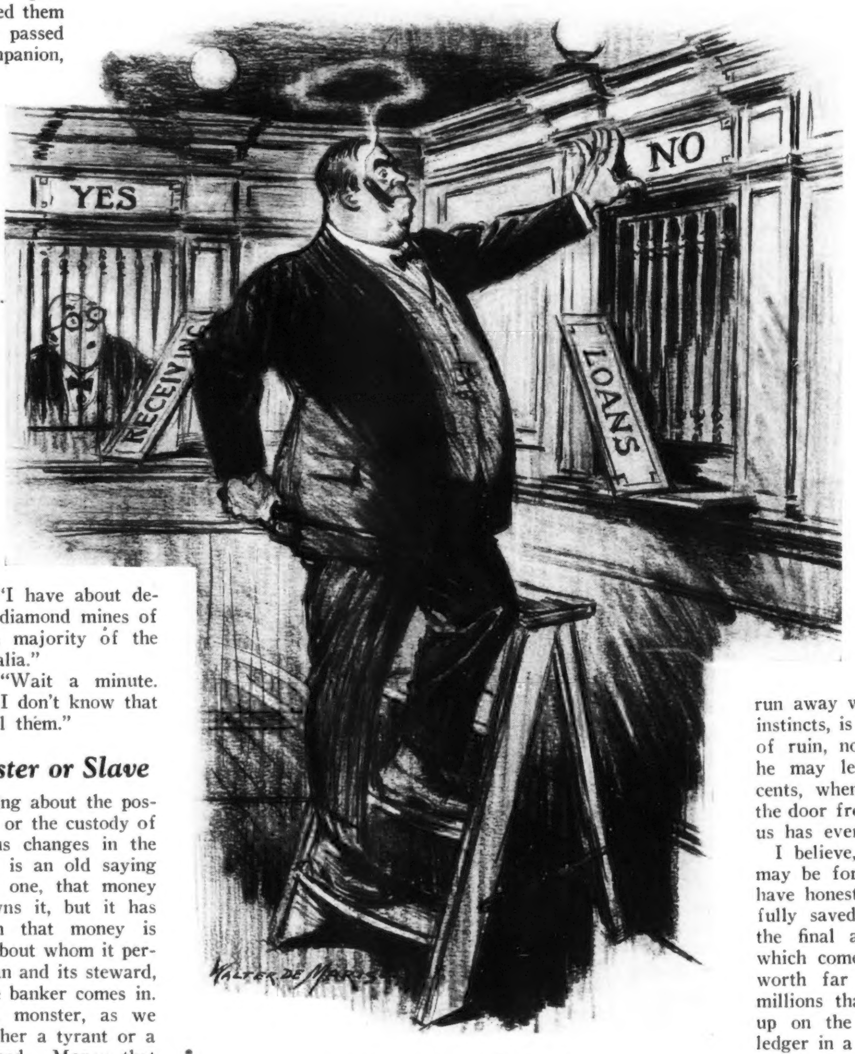
Now, those two had heard of the beneficent, elevating effects of those tiny crystals when taken in moderation. Moreover, they knew, from observation, the method of applying them. So they decided to experiment. Nothing that might happen to them could be aught but an improvement on their present state. So one of them put a few of the white particles on the back of his hand, and, following the prescribed method, sniffed them up his nostrils and passed the vial to his companion, who imitated him, and they moved on a few paces.

The bloom of youth rushed back into their unshaven cheeks, and one of them, drawing about him what was left of somebody else's coat and adjusting his tatters, said, "I am thinking of making some investments."

His friend, also well under the influence, said: "For example, what?"

"Well," the first wayfarer said, "I have about decided to buy all the diamond mines of South Africa and a majority of the gold mines in Australia."

His friend said, "Wait a minute. Don't be too hasty. I don't know that I am prepared to sell them."




*As Mr. Cobb Would Do It*

## *Money—Monster or Slave*

THERE is something about the possession of money, or the custody of it, that works curious changes in the human organism. It is an old saying and, I think, a true one, that money doesn't care who owns it, but it has been my observation that money is rather more careful about whom it permits to be its custodian and its steward, and that is where the banker comes in.

Money is either a monster, as we know, or a slave; either a tyrant or a friend in time of need. Money that you can boss is a blessing; money that bosses you, is the most intolerable curse that can fall upon the shoulders of anyone of us.

I used to have in my mind a typical picture of the usurious banker or money changer of fiction and of romance, presumably a descendant of the same creature whom Christ, with a scourge, drove out of the temple. Most of you know what the typical banker—the hard-hearted, flinty-souled, cheese-paring, greedy-handed banker of romance and fiction used to be. I used to picture him as an elderly man with a handclasp like the tail of a refrigerated and frozen eel, and an eye in his head like an undertaker's night bell, with those little red and blue lines in his cheek, like we see on a Treasury Certificate, which generally mean over-living and under-generosity when you find them in the countenance of a human being. That was the popular conception of the banker in the old days when fewer of us had money to deposit, and more of us had covetous designs upon the deposits of others.

Now, the absolute contrary to that fiction—the antithesis to that—is found today in the demeanor, the conduct (I am not attempting to cast bouquets at you but this is a compliment from the honest depths from a presumably honest heart of a notable member of the borrowing class) of the average banker of today, and, notably, the average country banker, and by that, I mean to speak in the metropolitan or New York sense with regard to the provincials. Any man, I mean, who does not live in New York, and is a banker, is regarded by the New York bankers as a country banker—the average banker today, in the average smaller community, or, perhaps, in the greater ones as well, is the charitable, understanding, generous soul, who within the mandates of his calling and the ethics of it, is the greatest contributor to the upbuilding of the community, of which he is a part.

## *A Little Philosophy*

IF I felt myself competent to preach to you men money—your own money and other people's money which you handle—I I would take from my text this: That the possession of money and the custodianship of it, should fill each one of you, not with conceit, not with arrogance, but with a more general understanding that the wealth, that the physical wealth of the world is but a temporary possession — that moths break in and thieves will steal — that he who puts his trust—that however fine it may be for the community, itself, that all should have bank deposits and should husband their resources against the inevitable rainy day—that he who lets the thought of collecting and amassing merely dollars and cents run away with all his decenter instincts, is skating on the edge of ruin, no matter how much he may leave in dollars and cents, when he walks through the door from which not one of us has ever yet returned.

I believe, however worthy it may be for each one of us to have honestly earned and carefully saved resources, that, in the final analysis, the wealth which comes from the soul is worth far more than all the millions that might be stacked up on the profit side of the ledger in a physical sense.

Before I quit I am going to tell you, if I may, a little story which has, I think and I hope, a bearing upon the very point that I have striven in the last few sentences to bring out. This story has to do with the richest man I ever knew, and he died practically a pauper, and it has one other merit, if it has none other, in that it is true.

## *The Country Doctor*

IN the southwestern part of this republic not so many years ago, there lived an old-fashioned country doctor, careless in dress,

(*Continued on page* 781)

# The Meaning of the New South

By OSCAR WELLS

**President American Bankers Association; President, First National Bank, Birmingham, Ala.**

**Great Diversity of Natural Resources in Region Between the Atlantic and the Rio Grande Will Enable This Section to Take Rank with the Middle West and the Far West as an Important Part of the United States. Where Pioneering Is Still Possible.**

THE trend of the times is away from the traditions by which our fathers were guided into a sort of serenity of confidence concerning the old South and its earlier characteristics. To those of us who have lived here long or who were reared here it amounts almost to an assault upon our patriotism for we have cherished our traditions.

A challenge has been given to us. It has come from many sources. The contemporary literature of other sections as represented by newspaper correspondents, magazine writers, publicists of all kinds, economists and financial experts are dinning into our ears the future possibilities of the South. It is pleasing music, much sweeter and more convincing than the strains that the Southerners always have sung about their own country. Is it any wonder that we catch some of the words of the new songs and try to set them to our accustomed tunes? This is the explanation of my theme. I want to go over the ground of a new set of facts concerning the industrial, economical and social development of the South.

As bankers seeking to render a banking service for the advantage of our own clients and to discharge our own responsibilities toward the complex needs of our own period with its interdependent relations, we are concerned about this awakening as to the potentail growth of our own country. Let us see what they are saying about us.

## *The Diversity of Resources*

IN the first place we are being reminded of our great diversity. As a matter of sentiment we have frequently acclaimed the fertility of our soil, the salubriousness of our climate and the hospitality of our people, but somehow these were regarded away from home as liabilities. They are becoming assets now as we apply the new standard of appraisal. To these are being added a more potent set of reasons. They are called natural resources. They range from agriculture to manufacturing. We have always grown cotton and it is still our money crop, but we are learning the science of diversifying. The growing of food and feed has become a good slogan with us. Vegetables and grain and fruits for the family, and grain and hay for the beasts of the plow. Live stock, another product of agriculture, is being raised more extensively. Under proper handling the conditions are favorable to growing both cattle and hogs less expensively in the balmy winters where the cost of shelter is negligible and where open weather admits of fattening the cattle upon the legumes over a longer period than in the ice and snow of the North and West. We have increased other crops too and have added new ones. Peanuts, sweet potatoes, pecans, the produce from the truck gardens tributary to the larger cities, tobacco, oranges, figs, grapefruit and melons are finding their way to the northern market from south of the Mason and Dixon line as well as supplanting at home the exported canned goods of other days.

These are a part of the natural resources but not all by any means. We have coal, iron, limestone, for steel making. Diversification plays a part here too. Where we once made only steel rails from our pig iron we now have more steel rails, cast iron pipe, heavy machinery such as sugar mills and cotton presses and gins, structural steel for bridges and buildings, cars, bars and plates. Fertilizer, tar products, coke gas, motor oil and cement are some of the by-products. We have slag for ballast and road building. Sheet mills are just beginning and we may expect utensils, smoke stacks, tanks, culverts and the like to follow. Cotton ties and hoops for barrels and kegs should not be overlooked, or steel wire and nails for home consumption and to send abroad. These are the main things from the steel and iron industry in Alabama. Birmingham has become also a center for Portland cement and all of the large American companies in this industry are located there.

## *Hydro-electric Development*

HYDRO-ELECTRIC power, another natural resource, is coming to the front in the South. Many large corporations are building dams and impounding waters. Muscle Shoals, a government project begun during the war, is an institution because it has been the subject of Congressional consideration. It is yet to be finished and its destiny, like that of most government undertakings, is yet to be determined. From the view of good politics we are tempted to make fertilizer for the advantage of the farmer, even though a government subsidy is needed. If we lease this mammoth enterprise or sell it as a power project to a distributing company we may get more out of it for the coffers of our treasury, but that would be to the advantage of the leasing or purchasing company composed of a few stockholders, and Congress would miss the political effect of having legislated for the people. Sound economics is not necessarily the best politics. With the growth of hydroelectric energy, industry grows. Our cotton mills, coal mines, electric furnaces and other forms of mechanical organizations are using electricity in the process of mining and manufacturing. We are just beginning to grow industrially, it would seem, and as we have vast deposits of hidden resources, revealed as yet only to the geologist, we may well have confidence in the future of our section.

## *On Top of the World*

AS the New South, a title now applied to the southern part of the United States, from the Atlantic on the east to the Rio Grande which separates us from Mexico, is constituted, we find even more products in this diversity of interests. In Louisiana, Texas and Oklahoma are produced vast quantities of oil, with the by-products of refineries, pipe lines, reservoirs, office buildings and transportation equipment. Along the Gulf Coast are located the naval store products of no mean dimension. There are the rice fields and sugar plantations of Louisiana and the lumber mills of Texas, Mississippi, Louisiana and Alabama to be taken into account. With this diversity of production as a background and with the growth we have made in road building, in the construction of new hotels, new theaters, new churches, new playgrounds of all kinds, including golf, there is no wonder that we feel that we are on the top of the world, figuratively speaking, as a section of these United States.

Florida is the modern lodestone toward which the whole country has been drawn. It has lain undeveloped so long, or in proportion to its opportunities has come forward so slowly, that there is little wonder that it has represented the greatest boom in land values that the present generation has ever known. Of course it has gone beyond all conservatism, and while some danger has been done to the individual speculator who made a marginal investment and then browsed about for another speculator, there is no reason to believe that whatever adjustment the conditions of the future may require will do any great injury to the structure of Florida's future progress. All of the subdivisions now under contemplation may not teem with bungalows as they are now covered with second mortgages, but the leading cities of your state are going to continue to grow with the influx of a new population bent upon living in leisure in the midst of a great playground or to produce for those who come to play. The crops of

(*Continued on page* 783)

# The Open Market Operations of the Federal Reserve System

By REUBEN A. LEWIS JR.

**Governor Strong of the New York Reserve Bank Tells Congress How the Purchase and Sale of Government Securities Lays the Foundation for Rediscount Rate Changes. Selling Drives Member Banks to Borrow. Purchase of Acceptances Different.**

THE part that the open market operations of the Federal Reserve Banks play in keeping the credit situation sound was recently described for the benefit of Congress by Benjamin Strong, Governor of the Federal Reserve Bank of New York. The head of the largest and most powerful bank in the Reserve System, and chairman of the Open Market Investment Committee of the Reserve System, revealed how the Reserve banks, by co-ordinating their purchases and sales of securities in the open market, have thus found it possible to give effect to their discount policy without making a change in the rediscount rates.

New light was cast on the operating policies of the Federal Reserve System under present conditions, as Governor Strong unfolded the plan and told of the machinery that had been developed during the past four years to keep the American financial system on an even keel. Reasons underlying changes in the discount rates, what the Reserve banks seek to accomplish through their open market operations, the extent to which the motive of profit governs the operations of the Reserve banks—these and other matters the intimate details of which have been little known or understood were discussed in the most candid and enlightening manner by the man, who probably has had as large a part in the perfection of the operating plan of the System as any other individual.

### Keeping Credit Sound

THE particular job of the Federal Reserve System is to keep the credit situation sound and, while some have the notion that it can control the sway of credit in much the same manner that a musician plays an accordion, Governor Strong suggested that its mastery was by no means so complete.

"I think the fundamental thing about the Federal Reserve System is that, holding the reserves of so many banks, the gold reserve of the country and being the source of additional credit when it is required by business, the Federal Reserve System through changes in the rate of discount and preliminary purchases or sales of securities in the market, has the power to influence to some extent, at times, the total volume of credit in the country and its cost," he said. And out of the experience of the past four years—which probably afford the best indication of what may be expected in normal times—Governor Strong observed that the Reserve banks have found that "the foundation for rediscount rate changes can be more safely and better laid by operations in the open market than would be possible otherwise.

"It has always seemed to me that the country has given exaggerated importance to change of the discount rate, sentimentally. The danger is that an advance of rate will operate as a sledge hammer blow to the confidence and security of the country as to credit—and that has been modified somewhat by these open market operations."

### A New Method

ALTHOUGH the Federal Reserve System has been in operation for more than ten years, the present method of influencing the course of credit by taking the initiative through purchases or sales of securities is a development of the past two or three years.

When the Federal Reserve Act was framed, the Reserve banks were given the power to operate in the open market—to purchase and sell cable transfers, bankers' acceptances, bills of exchange, Federal securities and certain types of obligations of minor political subdivisions. At that time, there was no American bill market. The whole of the national debt was around one billion dollars and the Treasury's borrowings were slight indeed when compared with the present—when there is a floating debt of about two billion dollars in short-term indebtedness. While it appears that the Act contemplated the Reserve banks would buy and sell securities in much the same manner that the central banks of European countries had done, the scant significance that was attached to the influence of the open market operations is indicated by the fact that although the Reserve banks were directed to make changes in the rediscount rates "with a view of accommodating business and commerce" nothing was said as to how the open market operations should be conducted. The framers of the Act gave each Reserve bank the right to go its own way in buying and selling securities and were silent as to the co-ordination of these activities.

Governor Strong, in tracing the course of these operations, related how each bank from the start of the System had gone ahead independently until May 1922 when it was realized that the general credit policy of the System might be partially nullified if there was not some singleness of purpose. During the latter part of 1921 and early in 1922, it was recited, the member banks got out of debt to the Reserve banks by liquidating their discounts. To offset this loss in revenue, the Reserve banks turned to the open market to keep their earning assets busy. They bought large quantities of bills and government securities. The widespread buying of Liberty bonds and certificates created what seemed to the Treasury to be an artificially high price for government securities—so the Treasury complained, for the Reserve banks were its own fiscal agents. To keep from treading on the toes of Secretary Mellon's department, it was decided at a meeting of the governors of the twelve regional banks in May 1922 to obtain some sort of supervision of these operations. A committee, composed of the Governors of the Boston, New York, Philadelphia and Chicago Reserve banks, was formed and a program developed for the orderly execution of orders without interfering with the local autonomy of any Reserve bank or endeavoring to influence any bank in its purchases for member banks. In the fall of the year, after the Federal Advisory Council had reviewed the plan and had expressed its approval, the committee extended its duties to making recommendations to the Reserve banks as to the buying and selling of government securities and to supervising the execution of orders.

### An Important Step

THE next important step came in the spring of 1923 when the Federal Reserve Board decided that it would be wise to reorganize the procedure of the committee. It set up a new committee, which was enlarged by the addition of the Governor of the Federal Reserve Bank of Cleveland and thus composed of five members. At that time it was determined that some purchases and sales of government securities should be actually made for the account of the System as a whole and distributed among the twelve regional banks. The operations were to be centrally guided through the chairman in New York and executed in all Federal Reserve districts where the markets existed and where purchases and sales could be effected satisfactorily. The committee, Governor Strong said, was to "act as the instrument for harmonizing the ex-

ecution of orders for the Treasury, the issue of Treasury securities and the execution of orders for the Federal Reserve banks on their own account."

At that time, the Federal Reserve Board laid down the principles that should govern the committee and declared that, inasmuch as there was a definite relation between rate changes and open market operations, "the time, manner, character and volume of open market investments purchased by Federal Reserve banks (should) be governed with primary regard to the accommodation of commerce and business and to the effect of such purchases and sales on the general credit situation." It further stated that "in making the selection of open market purchases, careful regard be always given to the bearing of purchases of United States government securities, especially the short dated issues, upon the market for such securities."

For the past three years, these principles have guided the five governors in their acts which have involved the purchase of securities running into the hundreds of millions of dollars.

The twelve Federal Reserve Banks now have more than a billion dollars of holdings of bills and securities—acquired by rediscounting the paper of member banks, by purchasing bankers' acceptances, by under repurchase agreements bills and government securities carried by dealers and by the outright purchase of government bonds and Treasury certificates. In all but one of these operations it is the member bank or dealer which ordinarily takes the initiative in putting Reserve bank credit to use. It is only in the outright buying of government securities that the Reserve banks take the initiative, Governor Strong stated. The tremendous mass of the banks' operations go through in an automatic fashion without any occasion for specific consideration of policy.

## *How the Reserve Banks Act to Influence Credit*

THE Reserve System does not go out to buy bankers' bills or seek to discount paper for member banks. However, there are two ways in which the affirmative policy of the System is undertaken. As Governor Strong put it: "First, in changes in the rediscount rates because, after all, it is by what we charge for the credit that we extend to member banks or to the public through the discount of bills or commercial paper that we control the volume. If they are discounting too heavily, or if other considerations make it necessary, we advance the discount rate.

"The other affirmative position that we take in exercising this control or influence is when we decide, upon our own initiative, to buy or sell some government securities—because these are not presented to us for discount. They would never come into the Reserve bank unless we decided to buy them and, of course, they would not go out unless we decide to sell them."

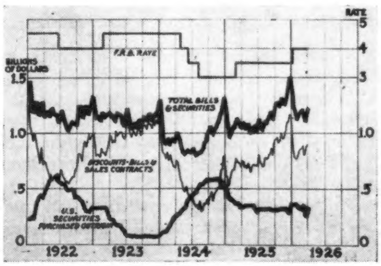
It has been found, he added, that by the sale of securities in the open market, the member banks can be driven to borrow from the Reserve banks and that they thus can convert an investment account into a borrowing account. When the member banks are in debt to the Reserve banks, it is then possible to exercise more control over the extension of credit to business and industry because the banks do not like to be in debt to the Reserve banks. It is generally recognized by the member banks that the proper occasion for borrowing from the Reserve banks should be to meet temporary and seasonal needs of their customers above the funds available out of the bank's own resources. The effect of this is to cause member banks when they are in debt at a Reserve bank to exert pressure for the liquidation of a portion of their outstanding loans and to be less free in the making of additional advances.

## *Changing the Character of Credit In Use*

WHILE some followers of the operations of the Reserve System have tried to make the point that the open market operations increase or diminish the amount of credit in use, Governor Strong emphasized that this was not ordinarily what happened. The purchases or sales of securities do not ordinarily affect the total volume of Federal Reserve credit in use, but they alter the character of that credit.

To show how this works out, Governor Strong cited the case of late 1922 and early 1923 when the Reserve banks had accumulated a total of around $629,000,000 in government securities by their independent purchases. There was what appeared to be a speculative or unhealthy development under way, so the Reserve banks sold all of their Federal securities down to about $82,000,000. The result of these sales did not reduce the volume of credit materially, he pointed out, but it did drive the member banks to borrow from the Reserve banks. As they got heavier in debt, the rate was advanced to 4½ per cent in February. The pressure of such a high discount rate—which is a penalty rate in a money center—became increasingly heavy and as a consequence of this and other factors such as an impending labor shortage and a generally conservative attitude in business, the speculative movement was gradually curbed, the rise in prices checked and the specter of over-production vanished.

In the fall of 1923, the member banks were in debt about $835,000,000 on direct discounts. At that time considerable importations of gold from Europe were flowing in. A noticeable recession in business was setting in. A severe slump in the New England textile industry had been suffered and the same was true to some extent of the rubber industry, some branches of the steel and other trades. A serious situation in banking had developed in the northwest. Banks, heavily in debt at the Reserve banks, were pressing borrowers to repay. Commercial paper was selling at 5 per cent and the New York Reserve bank's rediscount rate was 4½ per cent.




*This chart shows in a graphic way how the Reserve banks increase or decrease the volume of discounts by selling or buying government securities in the open market.*

Starting in November, the Reserve banks undertook the gradual purchase of short-dated government securities and acquired a total of $500,000,000 within the following eight or nine months. As the result of these operations member banks liquidated their indebtedness at the Reserve banks by an almost equivalent amount, interest rates fell until the period became known as a time of easy money. The New York member banks got entirely out of debt to the Reserve bank and the New York rediscount rate was gradually lowered until it was down to 3 per cent.

## *In the Bill Market*

THE Open Market Investment Committee also supervises the purchases of bankers' acceptances for the Reserve System and for the foreign banks of issue, for which the New York Reserve Bank acts as correspondent. Some of the balances which foreign banks maintain with the Federal Reserve Bank of New York are invested in the New York money market in acceptances and in short-dated Treasury issues. This business, according to Governor Strong, represents a natural development in the transition period between the abandonment of the gold standard and resumption of the gold basis—or the operation of the gold exchange standard, where the foreign banks of issue maintain accounts with the state banks or the banks of issue in countries which have free gold markets. The Reserve banks held bills on account of foreign correspondents amounting to $65,000,000 at the close of 1925.

The object of the operations in bills, however, is entirely different from the sale and purchase of government securities—it is to maintain an orderly world market and the nature of the operation is more or less similar to the discount of paper.

"New York is the main market where bills are dealt in and it is the principal market on which bills are drawn in the United States," Governor Strong said. "Boston is the next important point. This method of handling what we call the purchase of bills in the open market—it is really the discount of paper—is necessary because it results in an orderly market and, more important, it affords protection to the banks that are extending these drawing credits to the rest of the world and to the dealers, who deal in the bills. The development of the bill market in New York is the outgrowth of the need of the rest of the world to draw on the surplus credit of this country to finance the movement of goods, and especially of trade taking place between this country and foreign countries. It is highly important when an exporter in some remote part of the world is making a shipment of goods to America and drawing time bills representing the

sale price of these goods, that he know with certainty when that bill arrives in America in New York that it will be promptly accepted and have a certain market at a pretty certain rate.

"He must also know that when that bill is discounted and he gets a bank balance from that market that he shall be able to get the equivalent in gold if he wants it; otherwise he may suffer a loss by the depreciation of the exchange. So in a word, we are endeavoring to develop a market in New York where definite, certain and dependable facilities will be created for financing our trade with the rest of the world. The war has resulted in a development that has come much faster than would otherwise have been the case; and, on the whole, it has been exceedingly satisfactory. The freedom with which the organization of the Reserve banks stands ready to buy bills is one of the most important factors in developing that market.

"These bills are not purchased in the open market in the same way that the government securities are. The purchase takes more of the nature of a discount of commercial paper; that is to say, we have fixed rates at which we take paper that is offered to us.

## *Acceptance Rate Established*

"WE do not go into the market and buy them, making a decision on our own initiative to buy a certain quantity of bills. There is a rate established, at which we are known always to be willing to take bills from the market and they just come into us at that rate as the market offers them. As they come in, the bills are divided up by the committee, partly to fill orders received from foreign banks which have balances with us for investment and partly divided among the other Reserve banks in certain proportions, which are fixed from time to time with the approval of each participating bank.

"We purchase the majority of all the bills from the member banks, which are offered to us in the usual course of business. There are dealers in bills in New York and in some of the other Reserve bank cities, who at times come to us when there may be a temporary sharp advance in money rates to make temporary sales of bills to us in order that they may not be driven to dump their bills on the market and sustain heavy losses. This operation has importance in insuring that there will always be a stable market for bills at a fixed rate at the Reserve bank. The maintenance of this market is important in all parts of the world where cables are sent to buyers of bills at points of origin so that the buyer knows they can be discounted at a certain rate. In fact, most bills drawn on foreign countries in New York with the documents attached, representing shipments of goods, are sold very largely with forward rates of discount already fixed by cable so they know when the bill reaches New York, accepted and documents attached, that they will realize a given amount for that bill.

"The rates at which bills are bought are fixed by the directors of each Reserve bank and a minimum rate is approved by the Federal Reserve Board. The commission charged by a bank for accepting a bill of exchange will run, on the average, at a rate of about one-quarter of 1 per cent for a ninety-day bill, which is the value of the bank obligation on the face of the paper. There is possibly a reasonable allowance which should be made for the very narrow shade that is made by dealers in turning the bills over, of an eighth or sixteenth of 1 per cent."

Questioned as to whether there was competition in the purchase of bills between the New York Reserve Bank, the Bank of England and other foreign banks at times, Governor Strong explained that it was more a competition between markets:

"If the rate at which bills can be discounted at New York is somewhat below the rate at which they can be discounted at London, the tendency of the drawers of bills, with facilities for financing the movement of bills in the two centers, would be to draw on New York. If the London rate is below ours, the tendency would be to draw on London. The competition does not arise in the market where the bill is accepted but in the world's markets all over the globe at the point of origin of this paper, where drawn, in connection with the shipment of goods.

"A producer of rubber on the Malay Peninsula having a large shipment to make to New York or possibly to London, with banking facilities in both centers, might be expected to go to the agency of some bank in Malaysia and inquire what he could get for a bill in dollars or in sterling. He would get a quotation from that bank which would be largely fixed by the knowledge that the bank management has of the rate at which he could get discount for the bill either in the London market or the New York market.

"The great bulk of bills relate to primary commodities. As an indication of the variety of commodities financed in this manner, a list of bills covering two months' purchases by the Reserve bank in its operations in the spring of the year included: $75,000,000 cotton; $27,000,000 grain; $27,000,000 sugar; $18,000,000 coffee; $15,000,000 silk; $11,000,000 wool; $7,000,000 hides and skins; $7,000,000 copper; $5,000,000 lards and meats; $5,000,000 flour; $4,000,000 tobacco; $3,000,000 rubber; $2,000,000 cotton manufactures; $2,000,000 woodpulp; $2,000,000 lumber; $2,000,000 furs; $1,000,000 farm implements and all others $1,000,000, making a total of $247,000,000 of bills of that character purchased in 60 days, representing the flow of goods in the commerce of the country, mainly with foreign countries."

## *Answering Two Questions*

AN authoritative answer was made by Governor Strong to two other questions that have been frequently asked: the underlying basis on which discount rates are fixed and the extent to which the motive of making profits shapes the operations of the Reserve banks.

Without endeavoring to catalog all factors, Governor Strong stated that "the rates of discount are fixed after considering almost every element that enters into the credit situation which results from borrowing at the bank, including the consideration of the rates of interest in the market, the course of prices to some extent, whether speculation or inventories are piling up or not, whether the flow of business is uniform and even somewhat with relation to the foreign movement of gold."

As to the spur of profit making, Governor Strong said that there had been a change of heart as to the desirability of the Federal Reserve banks making enough from their operations to meet expenses and to pay dividends on the capital contributed by the member banks. As the directors of the bank have learned more of the philosophy of Reserve banking, he stated that they had come to realize there are conditions when it is not desirable to earn expenses and dividends. As the result of this the motive of earnings in purchasing paper in the open market has been entirely eliminated and the whole effort is being directed toward keeping the credit situation sound.

CERTAINLY one of the most interesting observations made by Governor Strong during his four days of testimony before the House of Representatives Committee was his view as to the efficacy of open market operations.

"The influence that the Reserve System exercises in the money market may be described in this way," he said. "If speculation, rise in prices and possibly other considerations that would move the Reserve banks to tighten up a bit on their use of credit come—and we have a large amount of government securities—it is a more effective program, we find by actual experience, to begin to sell our government securities. It lays a foundation for an advance in our discount rate. If the reverse conditions appear, then the purchase of securities eases the money market and permits the reduction of our discount rate.

"This is a big country, a vast organization to deal with, and a vast credit organization; and I feel that we have still much to learn about how those things should be done. So far as we have gone in our experience and under world conditions as they are, it seems to me that the foundation for rate changes can be more safely and better laid by these operations in the open market than would be possible otherwise, and the effect is less dramatic and less alarming to the country if it is done in that way than if we just make advances and reductions in our discount rate.

"A reduction in the discount rate, under conditions which may seem to justify it, establishes a pretty wide spread between market rates and this is not always a wholesome thing, especially in a big money market like New York. It is better, possibly, to let the credit filter out through the purchases and have the rates come down gradually and then we can reduce more in line with the existing rates in the market. At any rate, it seems to have worked pretty well this way in the past."

# The Power of Bank Credit to Influence Prices

**By LEWIS ALEXANDER**

**Congress is Told that the Federal Reserve Banks Can Prevent Extreme Swings in the Level of Prices But Cannot Regulate Commodity Prices. Price Stabilization Proposed as a Mandate. Governor Strong Gives His Views. What is Possible to be Done.**

## Credit's Influence

*BY changing the volume and cost of credit, the Federal Reserve System can prevent extreme swings in the level of general prices but it can not raise or lower individual prices. This is the substance of the conclusion that will be reached by the House of Representatives Committee on Banking and Currency, which has been conducting hearings on the Strong bill, a measure which would direct the Federal Reserve System in forming its discount policy to strive to promote stability in the price level.*

THE control of prices is beyond the power of bank credit, but extreme swings in the level of prices can be prevented by the Federal Reserve banks.

This is the common conclusion of a diverse group of our outstanding bankers and economists who have appeared before a Congressional committee inquiring into the question of how the country may escape the stark tragedies and unspeakable miseries that follow in the wake of a crash in prices —which is another way of describing an era of "drastic deflation." One after another, they have admitted that there is no magic formula by which the Federal Reserve banks can raise or lower the price level and, that beyond influencing the amount of credit that is employed and regulating its cost within certain limits, the reserve banks are almost powerless.

At the same time, it is conceded that the Federal Reserve banks can prevent wide fluctuations in gold prices by their action in making credit cheaper or dearer through changes in the rediscount rates or by influencing the amount of credit in use through their own purchases of securities and bills in the open market. Indeed, the fact that the general level of prices has been more or less stabilized during the past four years is cited as evidence that the Federal Reserve banks not only have limited powers to achieve stability but they have exercised them.

### *How the Bill Originated*

AS is the case with the bulk of legislative proposals that eventually engage the attention of Congress, there is a personal story behind this bill—a story of a zealous, persistent individual who believed that such a measure would go a long way toward solving the ills of the country. It is never safe to assume that merely because a certain Congressman introduces or presses a bill, he is the author of it, or that he is entirely committed to all it proposes.

Perhaps Congress might never have dug into the influence that the Reserve banks exert on prices or even considered a bill to direct the Federal Reserve Board, in establishing rates of discount, to make them with "a view to accommodating commerce *and promoting a stable price level for commodities in general*" with the further mandate that "all of the powers of the Federal Reserve System shall be used in promoting stability in the price level" if it had not been for the persistence of a white-haired, spare-framed investigator, who had made a tidy little fortune as a law book publisher and who took up the hobby of independent economic research. His name is George Shibley and he has been around the capitol for many years.

When Congress set about to frame the Federal Reserve Act, Mr. Shibley did his utmost to get the law so framed that the Federal Reserve Board would be charged with keeping the stability of the price level in mind in fixing its rediscount rates. He did succeed in getting Senator Owen of Oklahoma to include such a provision in the Senate draft but it never got into the approved law. He told the House Committee on Banking and Currency that he became interested in the movement for stable prices because a study of price levels showed that whenever there had been a period of deflation there had been hard times; whenever there had been inflation, seemingly good times obtained but bad results flowed from them. The zigzag course taken by the purchasing power of money always left a long string of victims behind. This spurred him along in his effort to see if it would not be possible to avoid this wreckage by devising some plan to keep the level of prices on an even keel.

Nearly a decade later, he took his fight direct to the Federal Reserve Board and succeeded in getting a hearing. He maintained, by raising interest rates, the Reserve System might force the price level down and by lowering interest rates the price level might be raised. In this way, he insisted, it might act to minimize crises.

It is understood that the suggestion was given extended consideration but in the end the Board concluded it would be thoroughly unwise to base its system of credit administration on prices. "Entirely apart from the difficult administration problems that would arise in connection with the adoption of the price index as a guide and entirely apart from the serious political difficulties which would attend a system of credit administration based on prices, there is no reason for believing that the results obtained would be as satisfactory as can be reached by other means economically valid and administratively practical," the Board said in turning its thumbs down. "Price fluctuations proceed from a great variety of causes, most of which lie outside the range of influence of the credit system. No credit system could undertake to perform the function of regulating credit by reference to prices without failing in the endeavor."

### *The Strong Bill*

THE door shut here, Mr. Shibley persisted. He succeeded in interesting Representative Strong in the measure as it was designed to bring about a more stable level of prices and there was at least some promise that farm products might share in this stability and thus spare the agricultural group from the throes of deflation. Mr. Strong was so impressed that he told the House of Representatives that "in place of the existing discretionary power in a majority of the eight commissioners on the Federal Reserve Board to bring on falling prices, they should be obliged by law hereafter to operate the Federal Reserve System to maintain stability in the index number of general prices—the price level."

It should be made clear that neither Mr. Shibley nor Mr. Strong ever indulged the idea that Congress should deliver a mandate that any individual price should be kept

at a fixed figure. However, Mr. Strong presented a chart to Congress showing the ragged, zigzag course prices had traveled in recent years and proposed a level for the stabilization of prices that was several points higher than the level prevailing in February when he addressed the House of Representatives.

The odds are overwhelmingly against any bill becoming a law. The holding of hearings by a committee having jurisdiction over a legislative proposal is a favorable sign but, by no means, an assurance that it has even a fair chance of passage. It is an open secret that the decision to hold hearings on this bill to a large extent was dictated by the realization that it would serve as a vehicle to permit the committee to inquire into the operations of the Federal Reserve System. The action of the Senate Committee on Banking and Currency in proposing the indefinite extension of the Federal Reserve bank charters by attaching unexpectedly a rider to the McFadden bill made it a live question.

There is scant likelihood of the House Committee taking a vote to advance the price stabilization bill but the testimony taken has thrown a great deal of light on an interesting banking question.

## A Mandate to Fix Prices

THERE has always been a variance of opinion as to the power of bank credit to influence prices and prosperity. There is no gainsaying the fact that it does affect both. The question is: To what extent?

The "soap-box economists" have encouraged the notion that prices can be inflated by pumping in a lot of bank credit in much the same manner that a toy balloon may be inflated by blowing in air or gas. Of course, such an idea has never been seriously entertained by bankers or careful investigators of the subject. The predominant fear of the practical bankers whose views were sought by the Congressional committee was that the direction that "all of the powers of the Federal Reserve System shall be used for promoting stability in the price level" would be interpreted as a mandate to the high officials of the system to fix prices.

Benjamin Strong, Governor of the Federal Reserve Bank of New York, referred to this danger. "If this proposal means a recognition by law that some power exists to bring about stability of prices and that it is to be exercised by some group of men, or some man, it seems to me that the public might easily interpret this amendment to the Federal Reserve Act as intending that Congress has issued a mandate to those men or to some man to fix prices," he said.

"I cannot believe that any such power to fix prices would prove acceptable to the people of this country or to the people of any democracy—if that is what it means. Personally I do not think that any such power exists or can be created to fix prices. What disturbs me about this proposal—not the purpose of the proposal but the way in which it is attempted is this: Much of the discussion of prices recently has arisen from the great misfortune that the farmers of the country have suffered, which we all recognize and deplore. If the Federal Reserve Act is amended in these words, is it possible that the farmers of the country will be advised or will be led to believe upon reading it, that a mandate has been handed to the Federal Reserve System to fix up this matter of farm prices?"

The query prompted Representative Wingo, of Arkansas, to observe, "the farmer already thinks you have that power and already thinks you are exercising it." Governor Strong pointed out that the adoption of the amendment would in no way increase the power of the Reserve Board to bring about a stable level of prices. "It is nothing more than legislation by declamation—a stump speech."

## Reserve System's Power

IN discussing the elements now under control of the Federal Reserve System tending to influence the price level, Governor Strong said the power of the System so far as credit is concerned could be exercised within certain limits in two directions—regulating or influencing the amount of credit that is employed in the country; and fixing or influencing the cost of that credit. There are certain conditions, however, where even this would not be possible, he warned.

"The Federal Reserve System does exercise some control, at times, over the total volume of credit that is employed in the country. It also exercises some influence upon the cost of that credit, by its discount rate and its open-market operations. Beyond that, the Federal Reserve System has no power to direct or control how the credit is used. We deal with it quantitatively; the member-banks deal with it qualitatively, as to its particular application. If member-banks and non-member-banks find it more profitable to lend money in one direction than in another, we have no power, of course, to control that.

"Being the source of supply of additional credit when it is required by business and the means of retiring that credit when it is no longer needed in business, the System through changes in the rate of discount and preliminary purchases or sales of securities in the market, has the power to influence to some extent, at times, the total volume of credit in the country and its cost."

## Situations Beyond Control

TO enforce the point that situations might develop where a period of inflation would sweep the land or there might be a decline in prices that the Reserve System could not control by inflationary or deflationary moves, Governor Strong said that everyone recognized that the amount of gold produced in the world had an effect upon prices and that so far no method had been devised of preventing an increase in monetary gold drifting into the banks from having an effect upon the volume of credit.

Changes in the Reserve laws were cited as a specific example of the possibility of occurrences quite beyond the control of the Federal Reserve System. If the suit brought by a group of banks against one of the Reserve banks to require giving immediate credit on checks deposited with the banks in course of collection were successful, it is calculated that the practice extended to all the Reserve banks would add from $600,000,000 to $800,000,000 to the reserves of the banks of the country over night. "The effect of this would be the equivalent of an importation in one lump sum of $600,000,000 or $800,000,000 of gold," he explained. "The effect of that would be to place at the disposal of member-banks a sum of reserve sufficient to pay off all the discounts of the Reserve banks to their members and if that should be done—it would be quite possible—we would have no loans on which our discount rate would operate. For a time at least, until a period of inflation had again built up a discount account in the Federal Reserve banks, we would be helpless to arrest it."

The repeal of the so-called war-time amendments to the Federal Reserve Act and the enactment of a bill to permit country banks to carry part of their reserves in the form of cash in vault or on deposit with the city correspondents would add about $400,000,000 to the reserves of member banks, he stated. This sum would be capable of supporting a very large inflation of credit—possibly eight or ten times that amount, Governor Strong calculated. "Any such influence as that upon the operations of the Federal Reserve System might tie our hands," he said. "We would have no influence at all until the inflation had run its course."

## Influence of World Conditions

WORLD-WIDE conditions frequently control the prices paid for American products—conditions that the American banking system can not control, he observed.

Governor Strong expressed the belief that, if American investors during the past two years had not furnished the rest of the world with two billion dollars of capital, it would not have been possible for the foreign markets to have paid for the American surplus crop production. It is that marginal surplus, which we do not consume, he said, that makes the price of the whole crop.

"Let us suppose that any occurrence abroad that might disturb American investors would result in a sharp closing of our investment markets," he suggested. "Europe is still in need of financial assistance. They are still in a period of recuperation and reconstruction. How would these crops be paid for? No amount of credit that we could introduce into the domestic market would have any effect upon the prices of the production of the farms that are fixed by world prices. The only result of efforts to raise the price level by an enlargement of the volume of credit would be to raise the prices of all the domestic goods which the farmer consumes and his fix would be worse than ever."

"There is no magic formula that can be introduced into the Federal Reserve Act to control prices. You cannot eliminate human judgment in the administration of these matters. I have discussed these matters with many economists and students of prices and purposely have carried the discussion through the same course. We have agreed on the record of the past in the Federal Reserve System pretty generally as to what has been done and the effect of what has been done. We have generally agreed as to the conditions at the present moment, when we have been discussing these problems. But when I ask them: 'Now we have got to decide something today; you are in

(*Continued on page 796*)

# Where the Bank Dollar Goes

By FREDERIC H. CURTISS
Chairman, Federal Reserve Bank of Boston

**Salaries and Wages Take from 15 to 25 Cents, Varying With Size of Bank. Interest on Deposits Gets from 8 Cents in Small Bank to 42 Cents in Fairly Large Institution. How the Boston Reserve Bank Has Developed a Yardstick to Measure Bank Operations.**

DURING the past few years, or more especially since the Great War, banks, like most business enterprises, have felt a steady increase in competition. This has brought about a reduction in earning power except in cases where more efficient methods of conducting the business have been developed. Higher costs of living have necessitated salary increases; and increases in interest paid on deposits—the increase in the growth of savings deposits being a factor—have also been a large item in the increased cost of operating banks. In certain of our large corporations a system of budgeting expenses, based on an estimated volume of earnings for the year, has been worked out with much success, but thus far the writer has never heard of this practice being put into operation in any bank.

Recognizing, however, that every banker likes to compare his own bank with other banks of similar size and doing a similar kind of business, and because of the lack of comparable figures on the subject, the Federal Reserve Bank of Boston began in 1921 to make some studies of the earnings and expenses of its member banks. Besides being thus limited geographically to New England banks, the study was restricted to the earnings and expenses data already on file at the Federal Reserve bank; *i.e.* the banks themselves were not called upon to furnish any information whatever, the statistical material used being all gathered from the semi-annual reports of earnings and dividends and the periodical reports of condition made to the Comptroller of the Currency by the national banks, and to the Federal Reserve Board by the member trust companies.

## *Basis of Comparison*

IN seeking to create a yardstick or a standard of measurement by which to compare any given bank with a group of banks, several considerations influenced the decision to use gross loans and investments as the basis of comparison. Gross loans and investments, including rediscounts and borrowings from the Federal Reserve bank and from other banks, represents the source of a bank's earnings, as they are the income producing portion of a bank's capital, surplus, deposits and other available funds. Gross loans and investments would appear to be more nearly comparable to sales in a mercantile or commercial organization, and therefore might be considered to afford a measure of the volume of business

done. In order that the earnings and expenses of those banks that had borrowed from the Federal Reserve Bank or other institutions should be comparable with those not having borrowed, and therefore the profits resulting from the use of borrowed funds should not be distorted, it was obviously desirable to include investments made out of borrowed funds.

Although capital, surplus, undivided profits and deposits may serve as a satisfactory basis for purely cost accounting purposes in any single bank which has undergone no radical change in its financial structure over a period of years, they were found inadequate for purposes of comparison of several hundred banks representing many variations of financial structure. In 1925 the percentages of capital, surplus and undivided profits to gross deposits in the member banks of the first Federal Reserve District varied all the way from 6 per cent to 508 per cent. It is obvious that two banking institutions of varying capitalization may show widely different rates of earnings and expenses although they may be approximately similar as regards both the character and volume of their operations, and the efficiency of their management as measured in terms of business handled, *i.e.*, loans and investments.

Although it is vital for a bank to have deposits and desirable for it to increase them, nevertheless, deposits are not of themselves a source of profit. It is a question of how such deposits and other available funds are used. As the loans and investments represent this use and are the source of expense payments and of distribution to the stockholders they appear to be the proper basis for a comparison of operating expenses. Even interest paid on deposits is, in the last analysis simply a cost of obtaining the funds to invest at a profit.

## *Avoiding Misleading Expenses*

THE greatest difficulty experienced in subdividing the various kinds of expenses arose from lack of uniformity in cost accounting practice, particularly in relation to expenditures relating to the banking house and premises. For example, one bank might own and occupy an entire building of the mausoleum type. A neighboring bank might own a large office building of which it occupied only a portion. Still a third bank might own no banking premises whatever but simply hire its quarters in a commercial building.

Taxes as reported in the required governmental forms, which are the source of information for this study, do not differentiate between taxes arising out of real estate holdings, and other taxes such as those on income, profits, capital stock, etc. Therefore, it is not practicable to compare taxes paid by various banks for the reason that one bank owning and occupying an entire building would pay entirely different taxes from those of another bank which rents its quarters, and, therefore, pays no such taxes. Still further confusion arises from the varying terms of leases by which a bank which owns and occupies only a portion of its building receives rentals from its tenants. Do these rentals include taxes or does the tenant pay the taxes? There appeared a wide divergence of policies between banks regarding depreciation and reserves. Some instances were found where banks charged anticipated taxes into a reserve fund without indicating that this transfer was to cover taxes; and not infrequently the ultimate actual amount of taxes paid out of the reserve fund could not be identified at all.

All of these questions made it undesirable and misleading to attempt to subdivide the various classifications of expenses more minutely than (a) salaries and wages paid, (b) interest paid on deposits, (c) interest paid on borrowed money, (d) all other expenses such as taxes, rentals, etc.

Another source of difficulty arising out of lack of uniformity in accounting methods occurs especially in a year like 1925, when banks were reducing their investment holding of bonds at prices materially higher than their cost in preceding years. When a bank charges off a probable loss against a security, the charge appears as a deduction *after* net earnings. Similarly, when such a security is ultimately sold any further loss beyond that covered by previous charge-offs should also appear as a deduction after net earnings. Both bookkeeping losses and actual losses should be treated alike, and should reduce *net profits,* rather than net earnings. On the other hand, if a recovery is later made on securities that

(56 banks) under $500,001 $350,000 | (84 banks) $500,001-$1,000,000 $740,000 | (103 banks) $1,000,001-$2,000,000 $1,500,000 | (97 banks) $2,000,001-$5,000,000 $3,300,000 | (40 banks) $5,000,001-$10,000,000 $7,000,000 | (36 banks) Over $10,000,000 $17,000,000 | (416 banks) F. R. District I Common Ratios

*Where the dollars earned by six different size banks went*

have been marked down or charged off or if the actual sale of a bond nets more than its book value, the difference should appear as an increase in *net profits,* rather than in gross or net earnings. Such a profit is an irregular or non-recurring transaction; it is in no way similar in nature to commissions or underwriting profits received by a bank's bond department in the ordinary course of its business from the sale of securities to its clients. Such profits when they occur should not be confused with normal day-to-day earnings. It is doubtful, however, if many banks actually follow this process of reasoning; and in many cases some items among those included in gross earnings will be distorted by the inclusion of profits on securities illogically included among current earnings.

## Valid Comparison Possible

IN spite of these obvious limitations, however, the studies of the Federal Reserve Bank of Boston have shown conclusively that it is possible, from material now at hand, to afford an individual bank a valid comparison with other banks, against which it can estimate in a broad way in what respects its local situation may coincide with or differ from the typical experience of banks of similar size and character of business.

At the outset it was found to be statistically misleading to compare any bank against the *aggregate* or *average* experience of any group of banks. A single large bank would overweigh a large number of smaller banks by being the dominating factor in the average. For example, a composite aggregate of all the banks in Federal Reserve District 1 would be, in large measure, simply a picture of banking conditions in the city of Boston, because the combined operations of the twenty-one Boston banks are equal in volume to the combined operations of all the 238 member banks in Maine, New Hampshire, Vermont, Rhode Island and Connecticut, together with a substantial part of those of the 159 remaining banks in Massachusetts. In fact, the operations of a single Boston bank alone are nearly as great as the combined total for all of the 164 member banks in Maine, New Hampshire and Vermont.

Another example, illustrative of the seriously misleading conclusions that might be drawn from using arithmetical averages or aggregates may be cited. A test was made on eleven closely similar small banks in New England. One of these banks during the year has shown a large volume of recoveries on charged-off assets; no other bank in this group had any recoveries on charged-off assets that year. Seven of the remaining ten banks charged off losses of one kind or another. The remaining three banks had neither charged-offs nor recoveries. Obviously the general practice of these eleven banks, as a group, was to charge off something for losses. Nevertheless, the volume, in dollars, of recoveries for the group as a whole exceeded the volume of charge-offs in dollars because the recoveries of one bank exceeded in volume the losses charged off by all the others combined. This gave an entirely erroneous picture of the normal or customary practice of this group of banks.

## Getting the Typical Figure

SOME other statistical method of procedure was, therefore, necessary. Two methods were available. One of these consisted of arranging the various percentages in ascending order from low to high, and considering as typical the common practice of the greatest single group of banks, designated by statisticians, as determining the *mode*—the percentage common to an outstanding number of banks.

The other method was to arrange the various percentages in ascending order from low to high and to select that percentage which was so located that there were an equal number of banks showing lower percentages, and an equal number of banks showing higher percentages, or what statisticians call, the *median.* In many cases no one percentage appeared to be definitely typical of a large proportion of banks; in other words there was no well defined "mode." Therefore, after extensive tests were made of all three of these methods, it was finally decided that the "median" afforded the most accurate unit of comparison by which to measure the individual operations of any given bank against a group of similar banks. In this way a common figure was obtained which was most nearly typical of the experience of the greatest number of banks. Each bank counted as a single unit in the comparison. The largest bank carried no greater weight than the smallest. And a few extremely high or extremely low figures did not seriously distort the final results.

In this manner common or typical percentages of expenses and earnings were obtained for the member banks in the First Federal Reserve District. Although the studies were restricted to the experience of New England banks, nevertheless, they are probably reasonably typical also of banks in other sections of the country where similar comparisons may not be available; even in those districts where such surveys have not been made, these New England ratios should serve fairly well as a standard of measurement against which to compare any commercial bank wherever located.

The banks studied were classified in two ways—according to their size and according to their proportion of time deposits to gross deposits. In this way a bank was enabled to see what is typical or normal for other banks of its own size, or for other banks doing a substantially similar character of business, as measured by the proportion of savings deposits handled. Both of these classifications furnished illuminating information regarding the operation of banks. The banks themselves were probably more interested in comparing their position with banks of a similar size than they were in comparing themselves with those doing a similar kind of business, regardless of size. But both comparisons are essential.

Because of the heavy interest charges on savings deposits (a type of business that is growing rapidly with the member banks) payments on account of interest on deposits ordinarily consume the greatest percentage of any single classification of expenses; but because the proportion of time deposits to gross deposits is lowest in the smallest and largest banks, the expense on account of interest is also relatively lowest in the smallest and largest banks and highest in the intermediate banks. Because clerical costs are higher in handling active commercial accounts than in handling inactive savings accounts, the relative expenditures on account of salaries and wages are highest in the smallest and largest banks. Consideration of the kind of business done is, therefore, essential for an accurate interpretation of the position of any given bank in relation to others of similar size.

It is significant that year after year the percentage of total current expenses to total gross earnings of banks having no time deposits at all normally runs in the neighborhood of 56 to 58 per cent. This percentage increases steadily and rapidly until, in banks whose principal business is that of handling savings deposits, total current expenses consume close to 75 per cent of all gross earnings. This is due almost entirely to the heavy outlay for interest on deposits.

During 1925 New England banks having no time deposits whatever ordinarily paid less than half of one per cent in interest on their gross deposits of all kinds. As the proportion of time deposits increased this percentage rose steadily to a figure of 3.2 per cent in banks doing principally a savings deposit business. In the former class of banks interest on deposits constituted only 7 per cent of all current expenses, whereas in the latter it constituted 65 per cent. On the other hand, salaries and wages in the former consumed 46 per cent of all expenses as compared with only 16 per cent

in the latter class of banks. It is not sufficient, therefore, for a bank to compare itself only with other banks of a similar size. It must give due consideration also as to whether or not the banks of its own size are doing a substantially similar volume of savings deposit business; if this is not the case, they should also compare their own earnings and expense percentages with a group of banks doing a similar kind of business.

## How Time Deposits Affect Net Earnings

CONCLUSIVE evidence has been furnished each year by studies made of banks' operating expenditures that the relative cost of operating banks increases as the proportion of time deposits to gross deposits increases. Consequently, percentages of net earnings show a tendency to decline with the growth of savings deposits. This is because the *rate* of profit diminishes as the proportion of savings deposits increases, even though the actual *volume* of profits may steadily rise.

The situation is analagous to that which a railroad faces when it is carrying a class of traffic which moves principally in one direction over its lines. As long as the freight cars must be returned empty in the opposite direction, it pays the railroad to accept any kind of freight at any sort of rates which will cover the mere out-of-pocket additional cost of loading, unloading, and running the otherwise empty cars which must be returned to the opposite end of the route in any event. Similarly, so long as a bank can increase its savings deposits without increasing its outlay for clerical expenses or overhead for housing space it pays the bank to solicit savings deposits even, though the cost for interest is high. But just as soon as the necessity arises for enlarging the overhead costs in order to handle these augmented savings deposits, the law of diminishing returns sets in so rapidly that it can hardly be considered a profitable business operation.

The fact that percentages of earnings on combined capital, surplus, and undivided profits increase progressively as the proportion of time deposits to gross deposits rises does not indicate greater earning capacity for banks doing a large savings deposit business; it simply indicates that they are relatively undercapitalized. In 1925 the typical percentage of capital funds to gross deposits, taking the 416 banks in Federal Reserve District I as a whole was 17 per cent. The corresponding percentage for banks doing primarily a savings deposit business was only 11 per cent. Of the forty-two banks having a capitalization below the generally recognized prudent minimum of 10 per cent, thirty-six were banks where more than half the gross deposits were in the form of time deposits.

These surveys have furnished some illuminating sidelights on local banking customs and policies in the different sections of New England. For example, the member banks in Maine carry a relatively large proportion of savings deposits; consequently, their expenditures on account of salaries and wages are ordinarily relatively low, while their expenditures on account of interest on deposits are high. On the other hand, in the adjoining state of New Hampshire the bulk of the savings deposits are in the mutual savings banks; in many instances the member bank actually shares its banking premises with a mutual savings bank and does no savings bank business itself. Consequently, in such banks the expenses for salaries and wages are at a maximum and the outlay for interest is at a minimum.

## Expense Percentages Stable

THE percentages, both for the various kinds of expenditures and for interest and discount earned on loans and investments, are surprisingly stable from year to year. Frequently, when interest rates are high the volume of deposits is low, and, conversely, when interest rates are low the volume of deposits is high. In this manner these two conflicting influences offset each other to a large extent. New England banks as a rule derive upwards of 90 per cent of all their earnings from interest and discount on their loans and investments.

Only in a few of the larger banks do outside sources of earnings, such as rentals received from office buildings, commissions, foreign exchange profits, trust departments, etc., contribute an appreciable proportion of the total gross earnings. Nevertheless, there appears to have been a definite upward trend in the proportion of total earnings derived from these outside, non-banking functions in recent years. In 1923, 1924 and 1925 the percentage of interest and discount earned on loans and investments, for all banks in New England considered as a single group, has varied immaterially from 5½ per cent. As is to be expected in periods of easy money, such as was experienced during the past three years, the small banks in the outlying communities enjoyed relatively the highest rate of interest. This is because they are able to utilize a substantial portion of their funds in meeting their own local commercial demands, and because they are not geographically readily accessible to the financial centers they are not greatly influenced by the easy money conditions prevalent in those centers. On the other hand, in times of money stringency the local rates of these smaller banks are less elastic than are those of banks in the financial centers; as a result, such banks are often unable to take advantage of extremely high rates which may temporarily exist in the more sensitive money markets.

As a result of these researches a simple and workable unit of measure has been attained by means of which any member bank in Federal Reserve District I can compare its own situation with that of other similar banks, with confidence that the comparison will not be distorted by undue weight being given to the figures of the large banks; at the same time an abnormal percentage arising out of any extraordinary local situation in any bank, whether large or small, will not materially affect the final results because each individual percentage is treated simply as one unit—one one-hundredth of the result in a group of one hundred banks.

While the studies thus far made by the Federal Reserve Bank of Boston of the subject of operating costs and earnings of the banks in the New England district have been productive of a wide degree of interest among banks and bankers, we feel that they may perhaps but be suggestive of the possibilities that still lie ahead in this field of banking research. Indeed, if these studies will but stimulate a greater interest on the part of the commercial banks in standardizing the classifications used by them in keeping their records of earnings and expenses along functional lines so that data on the subject can be reported in a more uniform manner with results, when tabulated and analyzed, more comparable than is possible at the present time, we should feel that a considerable forward step in banking administration will have been made not only by enabling individual banks to determine their position with relation to other banks but in the matter of internal budgetary control.

| *Percentages of* | *Percentages of Time Deposits to Gross Deposits* | | | | |
|---|---|---|---|---|---|
| | *0* (52 banks) | *under 25.1%* (104 banks) | *25.1%—50%* (97 banks) | *50.1%—75%* (116 banks) | *over 75%* (47 banks) |
| Gross Earnings, to *Loans and Investments* | 5.9% | 5.9% | 6.0% | 6.2% | 6.2% |
| Current Expenses, to *Loans and Investments* | 3.4 | 3.9 | 4.4 | 4.6 | 4.6 |
| Net Earnings, to *Loans and Investments* | 2.5 | 2.0 | 1.6 | 1.6 | 1.6 |
| Current Expenses, to *Gross Earnings* | 58.0 | 66,0 | 73.0 | 74.0 | 74.0 |
| Net Earnings (before losses), to *Gross Earnings* | 42.0 | 34.0 | 27.0 | 26.0 | 26.0 |
| Net Losses Charged Off, to *Gross Earnings* | 2.0 | 4.0 | 5.0 | 5.0 | 6.0 |
| Net Profits (after losses), to *Gross Earnings* | 40.0 | 30.0 | 22.0 | 21.0 | 20.0 |
| Salaries and Wages, to *Current Expenses* | 46.0 | 35.0 | 26.0 | 21.0 | 16.0 |
| Interest paid on Deposits, to *Current Expenses* | 7.0 | 28.0 | 51.0 | 55.0 | 65.0 |
| All Other Expenses, to *Current Expenses* | 47.0 | 37.0 | 23.0 | 24.0 | 19.0 |
| Interest paid on Deposits, to *Gross Deposits* | .4 | 1.2 | 2.2 | 2.7 | 3.2 |
| Capital Funds, to *Gross Deposits* | 43.0 | 28.0 | 16.0 | 13.0 | 11.0 |
| Time Deposits, to *Gross Deposits* | 0 | 5.0 | 40.0 | 62.0 | 80.0 |
| Net Earnings (before losses), to *Capital Funds* | 8.2 | 8.0 | 10.0 | 11.8 | 13.1 |
| Net Profits (after losses), to *Capital Funds* | 7.0 | 6.8 | 7.5 | 9.1 | 10.1 |
| Net Earnings, to *Capital Funds and Deposits* | 2.3 | 1.8 | 1.4 | 1.5 | 1.5 |
| Securities, to *Gross Loans and Investments* | 44.0 | 32.0 | 36.0 | 42.0 | 53.0 |

*Table showing how time deposits affect earnings of banks*

# EDITORIAL

## National Bank Circulation

THE future of the circulation privilege continues to be a live subject with officers of the national banks. Consols and Panama Canal bonds amounting to $675,000,000 carry the circulation privilege. Of that amount there is on deposit with the government $665,000,000 against which $661,000,000 in circulation is outstanding, As the government charges one-half of one per cent tax on circulation, the net cost to the government for the use of $100 is $1.50 per year.

If the government should always be able to borrow money at 3¾ per cent interest, then through these bonds, bearing the circulation privilege, the government saves about 2 per cent per year in interest, or an annual total of about $13,500,000.

Hence that saving would disappear if the note issuing privilege were withdrawn and an increase of $13,500,000 in the government's interest fund might be regarded as one item in the cost of withdrawing the privilege. The note issuing privilege cannot be withdrawn wholly save by act of Congress before 1930 when the Consols mature. However, the Panama Canal bonds, of which there are $74,000,000, have been callable continuously since 1916 and 1918.

The privilege is cherished by many bankers. It gives a singular prestige and advertisement to the bank. It is a time-honored institution which many bankers want to perpetuate.

## Changes In Banking Practice

WE wonder if there is a general realization on the part of the banker of the silent revolution that is taking place in banking in so far as direct relations with the customer are concerned. That there is in progress an important change seems to be pretty definitely indicated by such things as the agreement as to the size of bank checks; the interest in analyses of accounts; the country-wide application of the service charge; the establishment of credit files; the adoption of methods to detect the duplicate borrower; the urge to keep farm accounts; establishment of trust and savings departments in national banks.

All make for a better adjustment of the relations of the customer and the banker. All give promise of a new degree of efficiency. Some of them make for the better understanding on the part of the customer of his own affairs. As a whole they contribute to the prosperity of the customers as a class, more, perhaps, than to the prosperity of the bankers as a class.

## Over-Formal Advertising

THERE is much bank advertising that is so proper, so formal, so cautious, guarded and modified that it cannot make a very strong appeal to the reader. No doubt some of this over formal quality is due to the unfortunate circumstance that writers have had to keep in mind the necessity of getting the O. K. of conservative superiors in office; consequently, much effort is devoted to addressing a man who is already in the bank and from whom no new business is obtainable, and the real audience comes in almost as a secondary consideration.

We suspect that the public would turn with relief from the little essay so popular in bank advertising and would react better to the advertising that forgot it was advertising—that was informal, frank and free from conventionalities, and phrases which, after all, are just phrases.

A good bank is a great institution of service but there are lots of people in almost every community who have yet to learn how big a part it can be made to take in their lives and their prosperity, but they are not likely to be immediately impressed and spurred to action through reading advertisements so conventional that there is no ring in them.

## Are Dividends the Objective?

A GOVERNMENTAL department, organized to render a public service, is not commonly expected to pay dividends. Primarily, its function is to promote the well being of the people at large without thought or expectation of how much can be accumulated in the rendition of service. In many governmental functions even the suggestion of a consideration of profit would immediately mean the defeat of the end which government sought to serve. So, for instance, would it be in the judiciary, the legislature, and the executive branches. Though not a part of the government that is either fairly or accurately comparable to the governmental branches just mentioned the main objective in the creation of the Federal Reserve System was the maintenance of a sound credit structure, with profits as a lesser consideration.

It is not surprising, therefore, that in recent testimony before a Congressional Committee in Washington, Benjamin Strong, Governor of the Federal Reserve Bank of New York, indicated that within the Federal Reserve System there had been a change of attitude with regard to the policy of earnings of the Reserve banks.

In any corporation or enterprise in which he has a holding, or for the well being of which he shares a responsibility, the average successful business man is likely to be actuated by the impulse to make a good showing.

"With so little experience in banking of this character," Governor Strong explained, "it is quite impossible to ask nine active, intelligent, progressive business men, three of them bankers, to serve as directors of a Reseve Bank and right away, until they learn a little of the philosophy of reserve banking, to assume that one of their responsibilities was not to earn money enough to pay dividends on the stock; and I think I should state very frankly that many directors of many of the Reserve banks, strongly held the feeling that a part of their duty was to earn enough to pay the expenses and that any business man of experience would feel that way—not possibly realizing, as was the fact, that there were conditions when it would not be desirable to earn the expenses and dividends."

Asked if there were not times when paper was purchased in the open market for its earning capacity Governor Strong replied:

"I think that has disappeared with a better knowledge of the possibilities of the System. The subject of earnings as a motive in buying has not arisen for quite a while."

"In the original instance, I understood you to say that was one of the features" he was asked. "Yes" the Governor said, "and, of course, it was very desirable that the motive should be eliminated as soon as possible and it has been."

This policy is a trend toward that quality of public service referred to in the foregoing though, of course, there should be no expectation that in such circumstances profit can be completely erased. Reserve banks must have capital, and capital intelligently employed even with altruistic aims, cannot always avoid earnings.

## *Lots of Insurance But—*

EVERYONE is happy over the immense amount of life insurance that has been written in the last decade. It speaks well for the foresight of the average man, and for the prosperity of the nation. Every advance in insurance is like a strong girder in our prosperity.

No matter what the form of the policy may be, it is not true that the insured must die to win. That, like many another "smart" expression, does not ring true.

Everyone who for the first time or the last time acquires a life insurance policy commences to win from the moment the insurance begins. He wins a new sense of stability and satisfaction with himself. If he is head of a family, he wins a new degree of appreciation and respect. If he follows all the actions and reactions of insurance, he realizes that both directly and indirectly he is helping to provide capital for business which means work for men, and he is helping to protect other families besides his own.

The great increase in life insurance is an advance in general prosperity and a matter for congratulation, but the ideal condition will not be reached until everyone eligible, everyone with dependants, everyone with a business that would be harmed by his sudden retirement has some degree of insurance protection.

## *The Guaranty Law in Colorado*

TWO years ago an effort was made to have enacted in Colorado a state guaranty law. Bankers who were familiar with the operation of guaranty laws in other states, opposed the movement because they foresaw that there was more of disappointment and vexation in it than in the conduct of banking business without guaranteeing deposits. Their opposition was effective, but only temporarily effective, for lately there has been a revival of the project. Petitions are in circulation to have a state guaranty bill put directly on the ballot under the plan of initiative and referendum operative in Colorado.

This procedure is more dangerous than that of two years ago, for the idea of the state guaranteeing deposits—mistaken though it is—easily sells itself to those most likely to be the first to lose by it.

But notwithstanding the ease with which the idea is implanted into the mind of the average layman, such an obstacle to business and banking need not be set up in Colorado, if proper use is made of the abundant material found in the banking experience of those states which tried the guaranty plan, only to learn that it backfires.

## *"Let the Government Pay"*

THE strike in Great Britain, entering on its second week as this is written, may not be accurately attributed to one cause. Many causes have united to bring it about. There is, however, an interesting explanation which has been offered by one observer coming from England. He thinks that labor has been "coddled and nursed" to such an extent by subsidies and unemployment doles that the strike reveals a weakness of labor as well as a strength. The government subsidy has brought about a disposition to depend upon the government in an unusual way. If English workingmen are told that the normal operations of a business will not permit a certain increase in wages, labor is likely to retort, "Let the government pay the difference!"

If the English mine owners had to continue operations and pay the present rate of wages without the aid of the subsidy, the loss to the operators would be $3,000,000 a week. This would at once bring many of the companies to a crisis:—Either to drive straight toward bankruptcy, or close down. It is estimated that 50 per cent would close.

There may be something demeaning in unsatisfactory wages but in the long run there is likely to be little that is elevating in this idea of government subsidy, for the practice is, of course, wrong in principle and it eats at the foundations of government. Even if the governmental function of "paying the difference" could be kept within the limitations of certain trades or enterprises the practice still would be an evil.

Once started where can it be stopped? Satisfactory as it might seem to the first recipients of such aid, the government bounty, on a broad scale, would in the long run reveal itself as a burden instead of a staff.

The advocates of "Let the government pay the difference" do not state their case quite so bluntly here in the United States, but such proposals as that illustrated by the McNary-Haugen bill include the same basic thought. There is little likelihood that they would produce any different fruit in America than that which is ripening in Great Britain.

Whatever may have been the real part of the Russian disturbers toward producing the strike, it cannot be forgotten that when Great Britain resumed relations with the present government of Russia, the way was cleared for the enemies of the capitalistic system to carry on their work among the employed and the unemployed workers with better advantage than when relations were severed.

Industrious, misguided agitators, working with funds and literature supplied from a central source had an ideal field among men who, receiving an unemployment dole from the government, were embittered rather than placated by the allowance.

Where or when the strike will end no one could accurately predict at the end of the first week, for, from the very beginning, the strike had developed phases apparently unexpected by its proponents though not altogether overlooked by the government.

The economic loss of the strike cannot be confined to Great Britain. If the struggle is one of short duration, we shall feel it but little here, but if one of long duration, some lines of American business can hardly hope to escape its disturbing effect. The tie-up would, however, have to go into another phase, not expected even by the most pessimistic, before it could be regarded in the nature of a menace to the payment of the British war loan.

# Profits in the Steel Industry

By D. Richard Young

**Because of Its Basic Nature Steel Manufacturing is Subject to Severe Fluctuations. Last Year's Earnings Considered to be Favorable Because of the Relative Low Prices. Estimates of the Industry's Capacities. The Two Leading Companies.**

IN the study of business conditions, the earnings of representative concerns in the different lines of industry probably furnish a more reliable guide than does any other single factor. Bankers have always been interested in following earnings figures because of their direct bearing on credit risks, their effect on the bonds and stocks held for the bank's investment, and the indications they give as to general prosperity and purchasing power.

The steel industry because of its important position as measured by invested capital, value of products, etc., and also because due to its basic nature and the fact that its finished product is the raw material for so many other industries, is regarded as a barometer of general business.

Following is a tabulation of the earnings for the last three years of the leading American steel and iron companies which have published reports to stockholders and in the newspapers. The figures represent the net profits available for dividends or to carry to surplus; i. e., after all expenses, depreciation, interest, reserves, adjustments and provision for taxes have been deducted. Fiscal years and December 31 unless otherwise indicated:

**Steel and Iron Company Profits**
(000's omitted.)

| | 1923 | 1924 | 1925 |
|---|---|---|---|
| Acme Steel Company.... | 762 | 922 | 1,493 |
| American Rolling Mill Co.. | 3,473 | 2,845 | 2,886 |
| Bethlehem Steel Corp..... | 14,374 | 8,916 | 13,858 |
| Central Steel Co.......... | 2,007 | 2,900 | 3,374 |
| Cleveland Cliffs Iron Co... | 3,092 | 863 | |
| Colorado Fuel & Iron Co... | 732 | 520 | 1,752 |
| Crucible Steel Co. of Amer.[1] | 5,302 | 4,250 | 4,525 |
| Donner Steel Co., Inc..... | 1,116 | 543 | 793 |
| Eastern Rolling Mill Co... | 1,448 | 669 | 825 |
| Great Northern Iron Ore Properties ............ | 4,620 | 5,997 | |
| Gulf States Steel Company. | 1,577 | 979 | 1,037 |
| M. A. Hanna Company.... | 2,062 | *1,160 | 123 |
| Inland Steel Co. ......... | 5,275 | 5,475 | 4,870 |
| Interstate Iron & Steel Co. | 351 | 431 | 1,108 |
| Jones & Laughlin Steel Co. | 10,914 | 8,628 | 9,954 |
| Otis Steel Company....... | 1,361 | *1,479 | 1,404 |
| Pittsburgh Steel Company[2]. | 2,022 | 1,559 | 1,053 |
| Republic Iron & Steel Co.. | 6,252 | 1,918 | 3,813 |
| Sharon Steel Hoop Co..... | 1,809 | 491 | 511 |
| Sloss-Sheffield S. & I. Co.. | 2,491 | 1,516 | 1,979 |
| Truscon Steel Company.... | 1,379 | 908 | 2,104 |
| Trumbull Steel Company. | 2,771 | 2,244 | 1,576 |
| United Alloy Steel Corp... | 3,072 | 714 | 3,129 |
| United States Steel Corp.. | 108,729 | 85,035 | 90,603 |
| Wheeling Steel Corp...... | 5,251 | 865 | 4,073 |
| Youngstown Sh't & T'e Co. | 15,674 | 7,598 | 13,228 |

*Deficit.
[1]Years ended August 31.
[2]Years ended June 30.

## *Fluctuating Steel Production*

THE favorable showing during 1925 is all the more remarkable when it is recalled that last year witnessed a decided slump in production around mid-summer. The July daily average output of 118,800 gross tons of steel ingots, represented only 72.9 per cent of the February rate of 156,500 tons, but in the fall the mills resumed their higher schedules and the year's production reached the record total of 44,186,977 tons of ingots, as compared with 36,811,157 the preceding year and 43,619,200 in 1917, the previous record year.

The accompanying chart of the production of ingots over the last six years illustrates the wide swings in activity in the steel industry which years ago caused Andrew Carnegie to describe it as prince or pauper. Because of the basic nature of steel manufacturing it is subject to more severe fluctuations in demand than are the industries situated nearer to the ultimate consumer. Retail trade in staple commodities enjoys a marked regularity and is little affected by changes in financial and business conditions, but the industries making "producers' goods" operate by fits and starts. Steel mills will be doing a rushing business one season when there is a building boom or when the railroads are making heavy purchases of materials and equipment, then face a season during which idle plants, high overhead expenses, bond interest, etc., rapidly eat up their surplus.

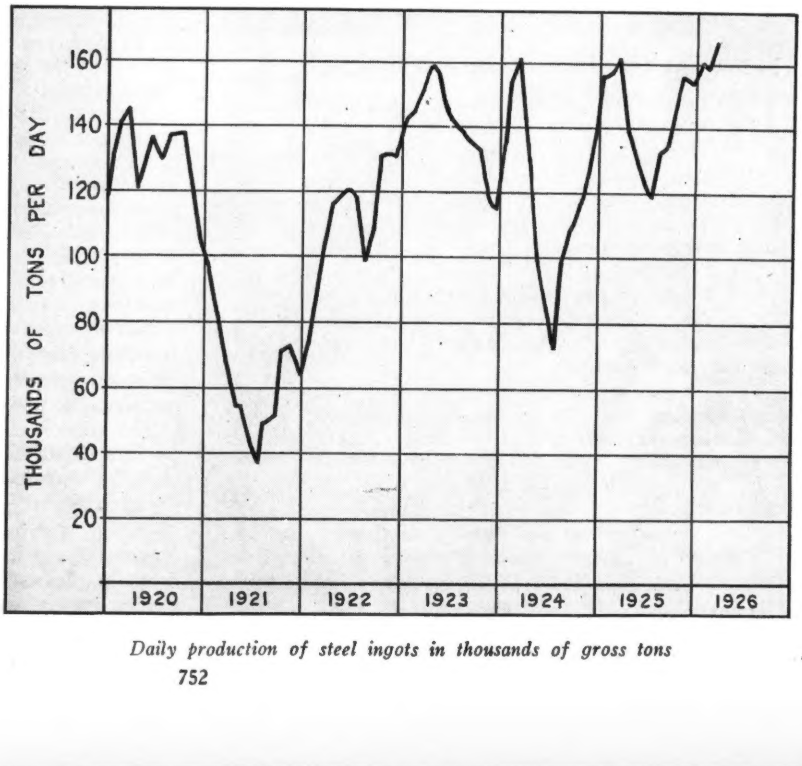
The March, 1926, production of steel ingots was at the rate of 166,359 gross tons daily, the highest level in history.

Another reason why last year's showing seems favorable is because the prices of steel products was somewhat below the level of general commodity prices, while wages paid in the industry have been increased greatly due to higher rates per hour and to the introduction of the eight-hour day in 1922. During the year 1925 the United States Bureau of Labor index of the wholesale prices of 404 commodities in primary markets averaged 159, based on 1913 as 100, while the iron and steel group averaged 138. The general commodity index stands at 152 at the present time, while the iron and steel group is 136.

## *Reason for Low Prices*

THIS low price of steel products is attributed to a number of causes, such as the existence of a greater plant capacity than is needed to care for the country's normal requirements, the habit of consumers to purchase in small quantities as needed instead of placing large unfilled orders as was the custom formerly, and the reduction of costs brought about through mergers and greater efficiency in management and operation. A contributing factor may be foreign competition, for last year imports of iron and steel products rose to 943,240 gross tons, the highest in history and comparing with 556,733 tons in 1924, while exports fell slightly below the preceding year.

It is doubtful if the steel making capacity




*Daily production of steel ingots in thousands of gross tons*

*The newly completed Maryland plant of the Bethlehem Steel Company near Sparrows Point*

of this country is much above requirements, for although a great deal of expansion took place during the war very little new plant construction has been made in the several years since then. The official figures of steel plant capacity for the trade are those collected and published by the American Iron and Steel Institute, an association whose membership represents a large proportion of the industry, and the estimate as of December 31, 1924, was 58,438,420 gross tons annually for ingots only. It should be added that these figures are based on reports submitted by members and are more likely to be above than below actual capacity. They may include obsolete furnaces that are not being used and probably never will be, this being notably true of old Bessemer furnaces, which in recent years have been practically displaced by the open-hearth furnaces. In some instances companies are unable to run their furnaces at full capacity because of the fluctuating demands which different classes of products make upon their rolling mills.

At a recent convention of the industry this question of capacity was one of the centers of discussion, and three leading manufacturers were appointed a committee to prepare an independent estimate, based on their own experts' calculation of the capacity of furnaces, rolling mills, etc., of each individual company; allowance to be made for the obsolete plants that are not likely to be used, and on a certain amount of time lost each year because of repairs and replacements. The committee after studying the situation gave out an estimate of 56,000,000 tons annually as the "theoretical capacity" for steel ingots only and 50,000,000 as the "practical capacity."

If the production of 44,186,000 tons of ingots last year be compared with the Institute figure of capacity, the ratio is 75.7 per cent, while compared with the independent estimate of "practical capacity" it is 88.4 per cent. Many people regard this as very low, and consider "100 per cent operations," which were characteristic of the war period and are still found in certain lines, as the only satisfactory rate. It is not so in the steel industry, however, according to trade authorities. Because of the swings incident to the business cycle, and to the carrying of idle capacity during repairs and as a reserve, an operating ratio of 60 to 80 per cent is considered quite satisfactory.

The custom of hand-to-mouth buying which has held down steel prices and earnings is by no means limited to that industry, but is now found in numerous other lines. It is based on the buyers' confidence that there are ample manufacturing facilities to supply their requirements on short notice, and the improvement in railroad freight service in recent years has assured fast and dependable shipments. We have a buyers' market instead of the placing of large unfilled orders on the books of the mills, which the latter could use as a back-log against periods of decreasing business, and as a basis for price advances in periods of increasing business.

## United States Steel Corporation

THE $90,602,653 net profits of the United States Steel Corporation appear large in comparison with the other companies listed in the foregoing table above, but if one considers them in relation to the invested capital of this leading concern they are very moderate. After payment of preferred dividends, this left a balance of $12.86 per share on its common stock (par $100). The Corporation had according to its balance sheet at the beginning of the year 1925, outstanding preferred stock of $360,281,100, common stock $508,302,500, surplus of $717,960,222 and reserves of $164,203,208 (not including the depreciation and depletion reserves that are in effect an offset to fixed assets), making a total invested capital of $1,750,747,030 at book value. The 1925 net profit represented on this an earning of 5.16 per cent. When it is realized that this is the foremost company and that the capitalization is very conservative and that during the twenty-five years of its existence the plant assets consisting of blast furnaces, rolling and finishing mills, iron ore and coal mines, limestone quarries, railroads, steamships and barges, cement plants, etc., have had total charges of $2,237,113,000 against them for depreciation and depletion and that their present valuation of $1,692,198,000 is much below the replacement cost, the profit of 5.16 per cent seems moderate. It is much less than would be expected in a good year from the leading company in most other lines, such as automobile manufacturing, oil production and refining, or chain store merchandising.

On April 27 the Board of Directors voted to increase the regular common stock dividend from $5 to $7 annually, which action replaces the old plan of paying $5 regular and $2 extra that had been in effect since the first quarter of 1924. This will require no more cash than before, but gives promise of extra disbursements in the future when earnings warrant. In 1910, when the common stock was first placed on a $5 basis, Judge E. H. Gary, chairman, announced that, if earnings permitted, the $5 rate would be paid regularly and any payments above that amount would be in the form of extra dividends. Although dividend payments were interrupted in the early war years, the $5 rate was otherwise maintained, with extras in some years, up to the present time. The new $7 common dividend, however, gives the stockholder actually less value than before the war when the rate was $5, considering the decrease in the dollar's purchasing power since that time.

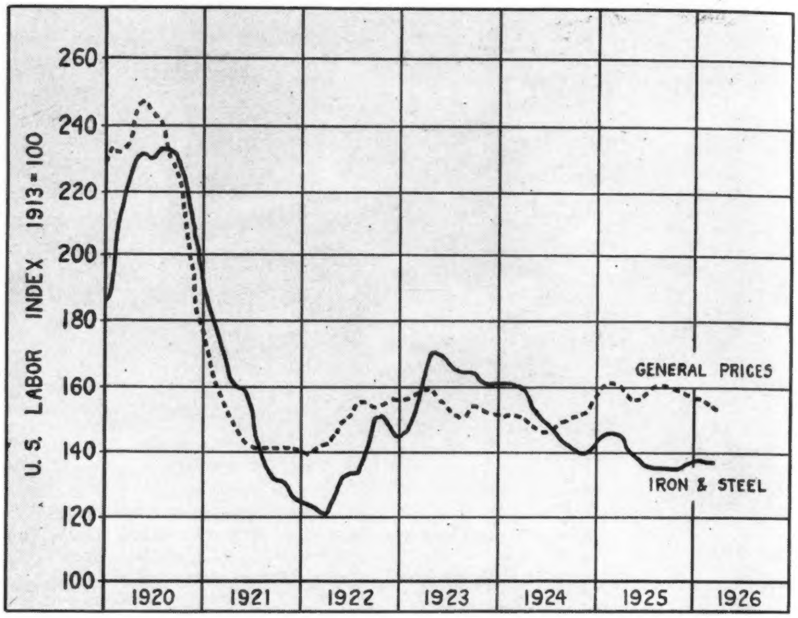
The second largest company in the industry is Bethlehem Steel Corporation, which expanded largely during the war because of armament and shipbuilding, and since then has acquired three other companies, the Midvale Steel and Ordnance Company, Cambria Steel Company and Lackawanna Steel Company. Bethlehem has spent considerable money in rounding out its organization in connection with these mergers and in turning to commercial steel production to which 92 per cent of its properties are now devoted, but like United States Steel, has every year made heavy charges for depreciation and carries its plant account at a very conservative valuation. The

corporation had, at the beginning of 1925, preferred stock outstanding of $59,432,510, common stock $180,151,900, minority stock of $8,465,625, surplus of $94,003,878, and reserves of $8,358,116, making a total of $350,412,029 invested capital. Last year's earnings of $13,858,196 represented a return therefore, of but 3.95 per cent on the capital invested and $5.30 a share on the common stock. Earnings for the first quarter of 1926 were equal to $2.66 per share on the common stock.

## *Many Unprofitable Companies*

IN any study of earnings in the steel industry it should be emphasized that the table shown above includes mainly the companies that rank high based on profits, and that every year there are a great many other comcerns that make very little money and some that operate at a deficit. It is not possible to show a complete table for all individual companies in the industry for the reason that the smaller companies do not issue reports for publication. One hears a great deal about the profits of the large and successful corporations, but very little of the concerns that are unable to show sizable earnings, or are in receivership or reorganization, or are being carried along by their bankers. If one relied only on the reports of the leading steel companies and concluded that everyone engaged in the iron and steel trade was making money, the picture is decidedly untrue.

For the showing of all companies, the annual reports of the United States Bureau of Internal Revenue, Income Tax Division, are the best and only source of information. While these figures are not published until a considerable time after the individual statements, the latest available being for the year 1923, they show conclusively that the steel business is not the royal road to wealth for everyone engaged in it. Following is a compilation taken from the reports for the years 1919-1923 to show the aggregate net incomes for all companies in the iron and steel industry which had net incomes, the Federal taxes paid thereon, and the aggregate deficits of the concerns which had no net income.




*How the level of iron and steel prices compares with general prices*

for financing plant replacements and normal growth.

## *The Outlook Satisfactory*

WITHOUT attempting to forecast the course of steel company earnings for many months ahead, there is no doubt but that the high rate of production so far during 1926 will mean good earnings for the leading companies, notwithstanding the comparatively low level of steel prices as compared with other commodities. The general business and banking situation is sound and prospects are that the current year will witness another large volume of business, though not up to 1925, so that operations in the steel industry should continue to yield satisfactory profits. Nevertheless it is not likely that production can continue indefinitely at the record rate prevailing at present, and there are indications of an end to the expansion in building construction and in the automobile industry, which two lines have played an abnormally large part in the general prosperity of recent years. New building took 15.32 per cent of the total steel production last year, while automobiles took 14.58 per cent. The railroads are the largest consumer, requiring 22.74 per cent of last year's output, and there is no reason to believe that their purchases will not be maintained, orders for locomotives and equipment being particularly good so far this year in contrast to the curtailed expenditures in this direction during 1925. The world production of steel last year largely exceeded the previous record of 1923, with Germany's 1925 production practically doubled as compared with 1924, and now ranking next to the United States for the first time since the war. These factors would seem to point to continued keen competition in the industry and to preclude any immediate probability of "boom" profits and extra dividends.

**Net Profits (or Losses) of Iron and Steel Corporations**

(From reports of U. S. Department of Internal Revenue)

| NUMBER | 1919 | 1920 | 1921 | 1922 | 1923 |
|---|---|---|---|---|---|
| Total number of corporations reporting net income.. | 1,688 | 2,091 | 881 | 1,407 | 1,799 |
| Total number of corporations reporting no net income. | 470 | 628 | 1,693 | 1,115 | 749 |
| Total number of corporations reporting.......... | 2,158 | 2,719 | 2,574 | 2,522 | 2,548 |
| Amount (000's omitted) | | | | | |
| Total net income of corporations reporting net income .................................. | $449,897 | $534,539 | $39,285 | $116,919 | $373,318 |
| Income and profits tax.......................... | 86,833 | 102,881 | 5,641 | 12,035 | 41,703 |
| Balance net income.............................. | 363,064 | 431,658 | 33,644 | 104,884 | 331,615 |
| Total deficits of corporations reporting no net income. | 13,770 | 15,951 | 121,572 | 52,994 | 26,756 |
| Balance net income after deficits................ | 349,294 | 415,707 | *87,928 | 51.890 | 304,859 |

*Deficit.

It will be noted that in each of the five years given there was a considerable number of concerns that reported no income, this number ranging from around 20 per cent of the total in 1919 to 65 per cent in 1921. Their aggregate deficits are a substantial offset to the earnings of the steel industry considered as a whole, as are likewise the taxes paid, which reduce by that amount the balance available to pay out as dividends or to retain in the business

## Resolution Adopted by Economic Council

A MEMORIAL to Congress, urging the approval of the French debt settlement by Congress "without political controversy," is to be presented as the result of the adoption of a resolution by the Executive Council. The resolution offered by Mr. Kent, reviews the circumstances under which the loan was made and says:

"The Debt Funding Commission, in carrying out its duty, together with the Honorable Ambassador from France have fixed an amount that both believe to be within the capacity of France to pay insofar as the intelligence of men can judge.

"Therefore, we the members of the Executive Council of the American Bankers Association, an organization with representatives from every state and territory in our great country, would ask that our Congress in approving this agreement, as we firmly believe it will and should, do so without political controversy and in such manner as to further the natural friendship that has existed between France and the United States since the beginning of our Republic and that will serve to stimulate peace, insure justice and increase trade for the moral and physical welfare of our respective peoples and of those in all other nations."

# The Paper Market—Coordinator of Credit Thought and Research

By ROY A. FOULKE
Manager Bank Service Dept., The National Credit Office

**Historical Outline of the Development of the Open Market for Commercial Paper. Four Distinct Periods. The Banker Who Never Refused a Loan. Brokers Who Carried the Paper in Their Tall Silk Hats. Borrowers by Basic Lines of Industry.**

*THE development of the paper market is an interesting chapter in our history. In this article the author divides the market's evolution into four periods: Prior to the Civil War; from* 1860 *to* 1880; *from* 1880 *to* 1900; *from* 1900 *to the present. There is a sharp contrast between the volume and importance of the market today and those days when gentlemen marketing paper carried the documents around town in their tall silk hats—but read the story, for it is a story rather than a history.*

THE open market for commercial paper began to provide the means for additional service to established commercial and industrial enterprises and banks a little less than a hundred years ago. Today it provides the mechanism by which banking institutions throughout the country yearly invest between $2,500,000,000 and $4,000,000,000 of their surplus funds in the short term obligations of 2750 representative commercial and industrial enterprises, obligations which afford the soundest type of secondary reserve.

One of the most important developments in the mercantile life of our country in the nineteenth century was the steady trend during the last quarter in the change in the form of bank borrowers' obligations from two name paper to single name paper. This evolution was necessitated by the development of the discount system in settling merchandise transactions in contrast to the previous current system of payment by notes and trade acceptances.

The evolution can be divided into four stages, (1) the period up to the Civil War when banks extended loans only against security or two name paper, (2) the period from 1860 to about 1880 when the bolder banks began to extend loans on single name paper and when discounts were offered for the prompt payment of mercantile bills, (3) the period from about 1880 to around 1900 when the policy of loaning on single name paper was considered a hazardous experiment but when the efficacy of cash discounts developed in all lines of business, and (4) the period from 1900 to the present time when the predominating portion of bank loans has been extended on single name paper and the need for taking discounts on mercantile bills has become uniformly recognized.

## The Period Up to the Civil War

JUST before the Civil War, our banking system was composed of 1392 small independent local institutions with combined capital of $421,880,095 and deposits of 253,802,129 in contrast to our present number of 28,841 banks with combined capital funds of $7,350,484,000 and deposits of $46,765,942,000. Accommodation based on the credit standing of an individual borrower was considered most precarious and against the very principle of sound banking. Statements either audited or signed were virtually unknown.

While two names formed the basis upon which bank credit was extended, only general information—often too general—was available regarding the financial responsibility represented by each name.

In a city where a borrower in need of further credit had no customers' notes to discount, he would exchange his note with that of a friend and discount it, (so-called accommodation paper) his friend discounting the exchanged note at a different bank.

The following example given by the late Mr. Forgan is typical of the nineteenth century credit methods: "In a town where I was learning the (banking) business a generation ago, it was told of a bank president that during a long banking course he had never but once been known to refuse positively any loan applied for. His sole requirement was a satisfactory indorser and if the borrower offering his note for discount did not comply with that condition, his uniform answer was 'My friend you will have to find another indorser.' The exception was in the case of an applicant for a loan who presented his note ten or twelve times having each time complied with the request that he get another indorser until the back of the note was well nigh covered with indorsements. Finally he secured an indorser whose name induced the president to depart from his usual formula and to say, 'My good man you had better start another note, the last name you have got on this one would damn anything.'"

The first written mention we have of commercial paper and the commercial paper business is contained in the volume written by the late Henry Clews on his Fifty Years in Wall Street, indicating that the commercial paper business sprang into existence in New York City somewhat prior to 1835:

"At the time I visited Washington (1861) my firm was more largely engaged in dealing in mercantile paper than any other branch of Wall Street business.

"I had inaugurated the system at the time of my advent to the Street of buying merchants' acceptances and receivables out and out, the rate being governed by the prevailing ruling rate for money, with the usual commission added.

"It was by this method that my firm soon became the largest dealer in mercantile paper, which business had formerly been controlled by two other firms for at least a quarter of a century, and whose old fogy methods were by my innovations easily eclipsed."

From this excerpt it is evident that the original dealers were brokers in the real sense of the word, taking the indorsed receivables and acceptances of well known dry goods distributors and turning the proceeds over only when the notes were sold, less the commission for selling.

Apparently the greater part of the paper handled by the brokers prior to the Civil War originated in the wholesale dry goods trade which sold merchandise on eight months terms and had additional need for credit. The practice of selling indorsed receivables soon passed into other important lines of industry, tobacco and diamonds, hides and leather, groceries, sugar and whiskey. Today practically every line of business handling merchandise; manufacturers,

jobbers, wholesalers and retailers obtain credit in the open market.

## The Period From 1860 to About 1880

FOLLOWING the reconstruction period after the Civil War, banks began to loan on single name paper and discounts were offered to buyers for the immediate settlement of trade bills.

From 1862 when $400,000,000 of United States notes were forced into circulation to 1875 when specie payment was resumed, our business like that transacted in most European countries today, was conducted with a fluctuating unit of monetary value. During this period greenbacks—our paper money—fell to thirty-five cents on the dollar.

It was this condition of our currency together with the scarcity of merchandise due to the diverting of machinery to war production, the rapid growth of the West following the war, and the coming of more rapid transportation and communication, which brought about the second stage in the change of the bank borrowers' obligation and the change in the method of settling merchandise transactions. Short terms were substituted for long terms and open account with a premium for prompt payment in the form of a discount was substituted for the practice of paying by notes or trade acceptances.

Merchandise was scarce and when perils and profits are large, sellers naturally pursue their own interests by eliminating as far as possible all credit risk by bringing business to a cash basis. Merchants in the East were unwilling to sell merchandise on eight months terms, six months or even four months when they had no assurance what currency would be worth at maturity. There was, therefore, every interest to bring business down to a cash basis, eight months credit was shortened to thirty days and in many cases to ten days.

Mr. Buell, president of the old Importers & Traders National Bank of New York City, is recognized as the first banker to show his depositors the advantages of borrowing on their own credit to obtain funds in order to discount trade purchases. Shortly after the crisis of 1873 the bolder city and then country banks obtained confidence in this procedure and proceeded to do likewise. The theory of discounts—which is an axiom in business today—grew up, that business concerns should buy merchandise or raw materials as nearly for cash as possible and borrow from banks to enable themselves to do so.

This system of borrowing by the buyer on his own responsibility has gone far in fifty years. Accounts Receivable have become the most liquid asset next to cash on a balance sheet. Under the old system, notes originally given for merchandise after several renewals became the worst kind of accommodation paper and enabled the borrowing customers of a bank to carry delinquent debtors indefinitely.

## Eight Months Customary Term

THE story of the change during this period from 1861 to 1880 has been told admirably by one of the prominent nineteenth century New York merchants, Edward D. Page:

"Up to 1861 credits had followed the system then employed and still employed in Great Britain for that purpose. . . . There were over three hundred wholesale dry goods merchants selling goods to western and southern retail houses, and financing the merchandise sold for a long enough term to provide for its complete turnover and cash liquidation from the proceeds of the crops. The customary term of that credit was eight months, and one or at the most two liquidations per annum were all that were commonly expected. . . .

"The farmer was so dependent upon the credit extended by the country merchant, and he upon that given by the wholesaler, that the seller practically charged whatever prices he pleased for his merchandise, profits were several times what they now are under our cash system, and New Yorkers who had never done a business of over three or four hundred thousand dollars a year retired early with fortunes or competences. To obtain money with which to pay the manufacturer or importer for his stock in trade, the wholesaler discounted the notes of the country merchant, of course indorsing them and thus made the double name paper. . . .

"This system continued satisfactory till the depression following the panic of 1873. By this time the number of dry goods jobbing houses in New York had been reduced to some thirty-five, and new wholesalers had sprung up throughout the West and Southwest. Far-away retail credits were no longer handled in New York, except through the medium of the regional jobber who soon came to have a credit of his own, based not on the carrying of merchandise, but upon that vastly better and more fluid asset, the possession of short-term accounts receivable due him from his customers. . . .

"Therefore the material no longer exists for the four months, six months or eight months bills receivable in transactions among the large houses in the wholesale trades. . . .

"In recompense we have the system of cash or short time settlements in the distributing lines of trade, and best of all the local extension of credit through the country bank, which has been evolved in response to this necessity."

## Sent Out to Offer Money

THE early development of the note brokerage business was closely confined to a very few houses. Besides New York City, early sales of single name paper were made in Boston and Philadelphia and throughout the eastern states. Amounts involved were large, the merchandise was small in bulk, and the offices relatively inconspicuous. These factors, which are equally as significant today as before the Civil War, together with the lack of publicity attendant to the increased use of the open market, were instrumental in the rather quiet development of the commercial paper field.

The sale of paper naturally dwindled to very moderate proportions during the Civil War. The disturbances, however, did not end with the termination of the war but continued to 1879 when specie payment was resumed. From the beginning of the war to 1874, money was scarce, credit was high, rates on commercial paper from 1866 to 1874 averaging around 8½ per cent for this entire period and ranging from 4¾ per cent to 17 per cent.

Up into the seventies it was the custom for country bank officers desiring to make investments in commercial paper to call at the brokers' offices and make their selections. In New York, however, the brokers early began the practice of calling on the banks and making offerings of the paper on hand. This was also true of Chicago.

In addition to buying commercial paper from brokers the larger New York institutions also purchase notes direct from concerns other than depositors. "One of the earliest recollections of business," says James G. Canon, "was as a young man I was sent out to 'offer money' to certain dry goods houses which the board of directors considered good. Only one or two banks in New York at the time had credit departments and the work of these departments consisted principally in noting up what certain directors had to say about the notes purchased." This condition demonstrated the need of brokers as banks soon found that the solicitation of paper from so many concerns made it difficult to keep track of borrowings. A concern might have paper in the hands of a half dozen New York banks and none would know the other was according assistance.

## From 1880 to 1900

ACCORDING to the classification of loans of national banks by the Comptroller of the Currency in 1880, about 81 per cent of the credit extended by national banks was extended on indorsed paper, 13 per cent against collateral and approximately 6 per cent on single name paper without other security.

By 1914 the percentage on indorsed paper had been reduced to about 36 per cent, the percentage on secured paper increased to approximately 38 per cent while the proportion of loans made on single name paper was in the neighborhood of 28 per cent. Of the $2,640,000,000 of commercial paper placed on the market last year, about 88 per cent represented straight paper or two name non-trade paper, over 11 per cent was secured by collateral, while less than 1 per cent was two name trade paper, indorsed receivables.

Henry Clews mentioned the fact that his company alone had $500,000 in receivables on hand in 1861. Today $500,000 is a rather moderate sum in the business world, but its significance during the early period of our commercial and industrial expansion is evidenced by the fact that no national bank was able legally to grant a line of credit of that amount until about 1880.

Following the panic of 1873 our financial condition improved materially and it was only a matter of time before specie payment would be resumed. The improved manufacturing processes which aided manifold production, specialization in industry and labor and brought about a buyer's market.

This fact together with the resumption of specie payment was the signal for selling on longer terms. The lengthening of terms, making it necessary for concerns to carry larger accounts and bills receivable resulted in the need for additional credit and concerns were compelled to borrow from their own banks or on the open market.

The expansion in our commercial and industrial life was based upon two factors from a financial viewpoint: The accumulation of capital which had been going on in American economic life for two hundred and fifty years, and the increased use of credit. A cotton mill now needed to borrow money extensively in the Fall to buy cotton, the cigarette manufacturer to buy tobacco, the meat packer to buy hogs, the grain elevator to carry grain until sold and the farm implement manufacturer to carry the farmer who purchased a new reaper until his crop was sold.

And so we find during this period the remarkable increase in (1) the number of banks as the West became more settled, (2)

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# Farm Surplus Largely a Myth

By MELVIN A. TRAYLOR
President, First Trust and Savings Bank, Chicago

**Worry Over the Shortage of Food with Which to Feed the Millions Has Given Way to Concern Over More Millions to Consume Farm Products. Comparison of Production and Prices in Two Five-Year Periods. Farming Brings More Than Wealth.**

WHILE we are inclined to worry more or less about everything affecting our welfare, there has perhaps been more concern displayed about our food supplies than about any other one necessity of life. In recent years, the subject of agriculture, and the welfare of the farmer, has been our most fruitful topic of conversation. Political fortunes have revolved around the unhappy situation of the farmer, and the business barometer has gone up and down with the varying proposals for his relief. So many and such conflicting statements have been made on the subject that it seems next to impossible to get a true picture and, therefore, to suggest what, if anything, is a possible remedy.

It is only a few years ago, as time goes, that there was a widespread feeling, voiced by the leading agriculturists of the country, that the time was rapidly approaching when America would not be able to feed its rapidly increasing population. All of us can remember the thrilling speeches and the seemingly unanswerable facts displayed to prove that production was gradually falling behind consumption, and that unless there was an improvement in soil culture, fertilization, reforestation, etc., the nation would face the dire necessity of importing a large percentage of its food requirements.

## The Myth of Surplus Production

I ACKNOWLEDGE, so thoroughly was I convinced of this fact, that on more than one occasion I argued, long and loudly, for diversification, intensive cultivation, and larger production. What is the situation now? The worry seems no longer to be for food for the hungry millions, but for more millions to consume our tons of food. Our evangelists of despair, so far as agriculture is concerned, have talked so much about over-production and surplus of agricultural products since 1920, that we are perhaps warranted in calling their attention to a fact or two with respect to production, which, if not news to them, may at least be enlightening to those who have no doubt felt that there has been a crushing surplus of the staples of the farm.

In the five-year period from 1911 to 1915, the average production of cotton was 14,175,000 bales at an average price of 12.41 cents per pound, while in the period from 1921 to 1925, the last year estimated, the production averaged 11,362,000 bales, at an average price of 21.85 cents per pound.

In the 1911-1915 period, wheat production averaged 806,358,000 bushels at an average price of 89 cents, while in the 1921-1925 period, the average production was 804,384,000 bushels at $1.11½ average.

In the former period, corn production averaged 2,754,000,000 bushels at an average price of 60.3 cents, while in the latter period, the average was 2,873,000,000 at an average of 69.6 cents.

Cattle on farms, January 1 figures in each case, for the period of 1911-1915 were 37,178,000 at an average estimated price of $26.52 per head, while in the latter period the annual average was 41,616,000 at an average estimated price of $26.08 per head.

Hogs on farms in the first period were 63,151,000, at an average price of $9.58 per head, and in the latter period, an average of 60,418,000, with an average price of $11.34 per head.

From these figures, it will be observed that, with the exception of cotton and cattle on farms, production has been almost uniform in the two periods, which eliminates, of course, the five-year period from 1916 to 1920 inclusive, which embraced the activity of the war and the early post-war inflation. In no case has production anywhere approached an increase commensurate with the increase in population between the two dates. It, therefore, seems perfectly obvious that the so-called surplus production is largely a myth, and the cause of the farmer's complaint, that he is not making a profit from his farm operations, must be looked for in some other direction.

## Complaints from the Few

SINCE the most pressing necessity of the human race is food and clothing, and since these elemental requirements must come from the farms and ranches of the country, the question of successful agriculture is at once fundamental, and since it must be admitted that all has not been, and is not, well with this industry, and since everyone else apparently is willing to express some opinion on the subject, may we not, without becoming too serious, ruminate and speculate somewhat about it ourselves? After all, what is the matter with agriculture?

In the first place, I confess I do not know, and in the second place, I plead guilty to having no clear-cut remedy, but there are a few facts which seem to me obvious, as a part, at least of the underlying causes of the present situation, and which, if correct, and if recognized and accepted, suggest themselves something of the remedy that sooner or later must be applied.

It seems to me that present difficulties had their inception largely in inflation of prices prevailing for agricultural products from about 1915 to 1920, with the consequent, of course, large expansion of profits from farming operations. This increase of profits led, as inevitably with the farmer, as with the manufacturer, to the expansion of plant and equipment, meaning, of course, the acquirement by the individual of larger acreage and of modern, if not always efficient, machinery for the conduct of his business.

These statements are general, and do not apply to every one engaged in the business, because in farming, as in other activities, there are always some who play the game safely and conservatively, and this is amply proved by the fact that there are thousands, literally millions, of farmers who have gone through the recent crisis without any difficulty or stress, and who are today prosperous, happy and contented. In fact, my information leads me to believe that the complaints today with regard to farming operations are coming from less than 25 per cent of the farmers of the country, and from the horde of politicians who are seeking to make capital out of the situation.

With the average, and, in this case, with the majority of those who were swept off their feet by the wave of prosperity through which they were passing, let us analyze the results of this inflation and expansion. The farmer who was operating on land, let us say, that he was carrying in his capital account at a value of $100 per acre, and who perhaps had a loan of $50 an acre, suddenly found that because of the increased profits from his operations, his land had a market value of $200 per acre, and he also discovered that if he had a new tractor and some new farm machinery, he could greatly increase his production, but if he did that, he would need a larger barn and more warehouse facilities; and the chances are that with an appraisal of $200 per acre on his land, he increased his loan of $100 per acre, thereby doubling his capital account and his bonded debt, not out of earnings, but as we would say, because of his ability to effect a "clean write-up" of 100 per cent on his plant account.

## Increased Capital; Reduced Income

IF he did not effect the doubling of his capital account in this manner, and if his $100 acre farm was clear, he probably bought his neighbor's farm for $200 per acre and mortgaged both the new and the

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# Passing Events Pictured in Cartoons


*No Longer a Thriller—Hall for the King Syndicate*


*The Latest Model—Kuhn in the Indianapolis News*


*Those Wild, Wild Flowers—Brown in the New York Herald Tribune*


*All There Was—Darling in the New York Herald Tribune*

*The Audience Will Kindly Refrain from Applause Until the Act is Over—Darling in the Fall River Herald*


*The Sheep-Shearing Season—Hanny in The Philadelphia Inquirer*


*Trying to Keep in the Middle of the Road—LeCocq in the St. Louis Globe Democrat*


*Where Prices Are Fixed—Harper in the Birmingham Age-Herald*


*Speaking of Size—Smith for the Newspaper Enterprise Association*

# German Banks' Progress in 1925

By ROBERT CROZIER LONG
Correspondent at Berlin

**Notwithstanding the Reduction in the Rate of Interest and the Lack of Opportunity for Profits in Bond Issues, Condition is Regarded as Favorable. Discussion of Possibility of Earnings in Excess of Surface Conditions. Shares Held in Other Countries.**

BEFORE the end of March all the leading German commercial banks published their reports for 1925, the second complete year of currency stability. The reports accurately reflect Germany's progress in the preceding twelve months and her incidental set-backs. Intrinsically, 1925 was a much less interesting year than 1924, for 1924 began only six weeks after President Schacht of the Reichsbank initiated his dramatic and unprecedented experiment with the pure paper rentenmark, an experiment without which neither the Dawes Plan nor the subsequent creation of the new reichsmark currency could have been conceived.

Owing to the precipitate rentenmark reform of the preceding November, 1925 was in itself a year of hazard, almost of gamble. At the beginning of the year probably not ten Germans of authority—the chief of the ten was Schacht—believed that the rentenmark would maintain its stability. Lenders of all classes, including the Reichsbank, showed their doubt by charging as much as 90 per cent per annum interest on loans of which about 80 per cent was really a premium exacted in order to secure creditors against the risk of resumed currency depreciation. Banking procedure in the first stable-currency year was therefore tentative, uncertain, even hazardous. But the year, despite distrust and dolorous anticipations, progressed satisfactorily, and ended with the Dawes Committee of Experts seated in Berlin, and with a new sentiment of security and hope.

## *Banking Recovery Complete*

COMPARED with 1924, the banking year 1925 was inevitably dull. Business was nearly normal. Not banking reconstruction, but banking consolidation characterized the second stable-currency year. Development though sure was comparatively slow. Development is inevitably rapid when the starting point has been abnormally low. That was the condition at the beginning of 1924. There was very little currency in circulation—to be precise, only 2,277 million marks or little more than a third of the 6,071 million marks in circulation at the end of the last pre-war year. As this circulation had doubled to 4,273 millions before 1924 was out—the increase reflecting itself in increased deposits, loans and clearings—the recovery of banking business was abnormally rapid. As was to be desired, in 1925, the pace slowed down inevitably. The circulation rose to a further 5,181 millions, and then came to a stop. The volume of banking business increased with corresponding slowness. This slackened development was healthy and normal.

The seven great German commercial banks developed according to this principle in 1925—with relative slowness but with unmistakable sureness. Business increased; and though the pace continued to slacken in the later months it continued until the volume of business nearly reached that of the best pre-war years. In some cases it fully reached that of pre-war years. By the end of 1925 the recovery of German banking was for all practical purposes complete.

The factors which fostered this slow but sure recuperation are known. Home trade developed, though it had a serious setback in the second half of the year. Foreign trade increased beyond the most optimistic expectations. Foreign loans, particularly toward the end of the year, flowed in copiously. There was a very notable growth in national earnings. In the two stable-currency years the wages of manual workers almost doubled; and as a result thereof savings grew so much that in 1925 deposits in the savings banks increased by one billion marks, and so exceeded the best pre-war record, which was under 700 million marks. On the basis of a genuine national growth, but of course with the help of foreign credits, the circulation of currency increased without risking inflation of prices and therefore risking home currency depreciation. How well justified was the year's increase of circulation is shown by the fact that the wholesale price index declined from 138 to 117. The rentenmark which remained in circulation, and the new reichsmark which was the creation of the present Vice President of the United States, both not only retained fully but also materially increased their buying power and as a result of this a given unit of banking transactions of any kind represented an increasing volume of commercial business done.

## *The Drop in Interest*

BUT there was nothing sensational about the banking year 1925. It was dull with the satisfactory dullness of stability. Not only did business increase at a retarded speed, but also profits underwent an appreciable decline. These reduced profits are a good sign. It was extremely easy for banks to earn large profits when they were charging debtors 90, 50 or 30 per cent interest and allowing depositors 8 or 10 per cent; it was distinctly harder to earn them when the "spread" fell from 80 or 50 per cent to 5 or 6 per cent. And as the rates of interest fell not only because money was more plentiful but also because the charging of a risk premium was unnecessary the reduced profits are emphatically a proof of increased confidence.

The seven German credit institutions which are customarily classed as Great Banks are the "D" banks and three others. In the first group are the Deutsche, Disconto, Darmstaedter-und-National, and Dresdner banks; in the second group the Berliner Handels-Gesellschaft, which is a pocket interest of the able banker Fuerstenberg, the Commerz-und-Privat Bank, and the Mitteldeutsche Kreditbank. The positions of these seven banks, taken together, at the end of 1925 as compared with the end of 1924 and the end of the last pre-war year, was:

| | 1925 | 1924 | 1913 |
|---|---|---|---|
| | Millions of Marks | | |
| Deposits and Current Liabilities .............. | 4,897 | 3,472 | 4,808 |
| Loans and Discounts.... | 2,457 | 1,606 | 2,850 |

These figures show that in general the value of transactions carried out practically recovered to pre-war level, though owing to the price rise the volume of commercial business done was considerably smaller. That the rate of recovery by the different institutions was very different is shown by the following separate figures for the four "D" banks:

| | Deposits | | Loans | |
|---|---|---|---|---|
| | 1925 | 1913 | 1925 | 1913 |
| | Millions of Marks | | | |
| Deutsche ..... | 1,240 | 1,580 | 682 | 638 |
| Disconto ..... | 893 | 674 | 466 | 391 |
| Darmstaedter .. | 859 | 847 | 429 | 619 |
| Dresdner ..... | 1,004 | 958 | 461 | 624 |

The considerable excess of deposits over loans has its explanation. It is estimated that 20 per cent of the deposits were in foreign money. The relatively high interest rates prevailing even at the end of the year attracted foreign money. Further, foreign credits played an ever-increasing rôle. The first American, British, Dutch and Swiss loans and credits very largely went upon payment for foreign raw materials and other goods; and this showed itself in the heavy monthly import figures and enormous passive trade balances which prevailed until late in the year.

## *Never Reached Germany as Currency*

THE yields of the foreign loans were not converted into German currency at all and as currency they never reached Germany. Later as the depleted store of raw

materials was replenished and as the manufacturing crisis became worse, the need for importing slackened; and this process was shown in greatly reduced import figures, and ultimately in an active trade balance in December 1925, the first such balance since August 1924. Owing to this change of conditions, the foreign loans received here in the original currency were transferred to the Reichsbank, which gave out reichsmark notes in exchange. The normal course would have been to use this new foreign-fed mark circulation as home working capital, but the manufacturing stagnation prevented that, and the money remained in the commercial banks as deposits.

A further factor in the growth of deposits in 1925 was the realization by Germans of their old foreign-currency and foreign-security holdings. These holdings dated from inflation time, when they were acquired as part of the process called "the flight from the mark." As soon as the currency proved stabilized beyond all risk, the reason for such foreign holdings disappeared; and dollars and pounds sterling, and to some extent also foreign securities, were sold and the mark proceeds were intrusted to the banks in a sense of security. While therefore part of the considerable increase in deposits in 1925, and also in 1924, represents new national savings, by no means has all of it that meaning. In the present year's development of the banks, such realizations of foreign holdings will play a relatively small rôle, and therefore practically no increase in deposits from this source can be expected.

Although progress in the volume of loans and deposits was slower in 1925 than in 1924 it nevertheless occurred. But in the matter of banking profits, no progress at all was made. For increased profit-making all the conditions precedent except one were lacking. This exception was the growth in the volume of discounts and loans.

## *Few Bond Issues*

BUT the increased opportunity for profit from such sources was counteracted by other factors. First, there was the enormous decline in the interest "spread." Second, other classes of business actually declined in volume. Before the war the banks reaped large profits from commissions on capital issues by public bodies and private corporations. In 1925 commissions from such services ceased almost entirely. In no month of the year was the volume of new loan and bond issues considerable; and in several months not one transaction of either class took place. The unexampled inactivity, combined with extraordinarily low quotations, of the stock exchanges also operated against profits. Normally the banks are the real stockbrokers of the German public. Through them nine citizens out of ten buy and sell stocks and bonds; indeed if one ignores the official or "sworn" brokers who are practically bourse officials and whose function is merely to fix the day's quotations, stockbroking in the Wall Street sense plays a wholly unimportant rôle. In ordinary years therefore the banks reap very large profits from commissions on dealings in bourse securities. In this respect 1925 was an unfavorable year. After the first two months the bourses were increasingly inactive. And as quotations were very low, the receipts from commissions, which in Germany are calculated not on the number of shares but on the price paid for the shares, fell off more and more.

As result of these unfavorable conditions, the recovery of banking was not accompanied by increased profits. Taxation and social burdens remained approximately unchanged. The banks partly overcame their troubles by continuing the policy of retrenchment which they initiated after the currency stabilization. Many branch offices were closed; and the seven banks mentioned further reduced the number of their employees from 72,000 to under 50,000; and tried to economize by resorting to mechanical banking appliances, mostly American in origin. Of this so-called "mechanization of banking" the heads of German credit institutions talk very much, ignoring the fact that the incredibly dilatory and bureaucratic methods of their clerical staffs is the real reason why administration expenditure is so extravagantly high.

## *Concealed Profits?*

NEVERTHELESS all the seven banks without exception declared for 1925 exactly the same dividends as for 1924. This fact, and the fact that, despite radically changed conditions the net profits returned do not differ materially from those of 1924, has created a suspicion that accounts have been doctored—not necessarily in an illegitimate way and rather by concealing profits than by concealing losses. One of the best German banking experts publicly suggested that before compiling their reports for the year the Berlin banks had a friendly conversation over the lunch table; and that having there decided that the dividends of 1924 should be repeated, compiled their balance sheets and profit-and-loss accounts accordingly. Without putting it quite as crudely as that, one may say that this was approximately the method. Even a summary examination of balance sheets indicates that very considerable assets are not divulged at all.

The dividends declared for 1925, as for 1924, and the gross and net profits may be summarized thus:

| | Dividend % 1925 and 1924 |
|---|---|
| Deutsche | 10 |
| Disconto | 10 |
| Darmstaedter | 10 |
| Dresdner | 8 |
| Berlin Handels-Gesellschaft | 10 |
| Commerz-und-Privat | 8 |
| Mitteldeutsche Kredit | 8 |

The gross profits of the seven banks fell behind those of 1924 by some 40,000,000 marks. The figure for 1925 was 397,570,000 marks, as against 439,900,000 marks in the preceding year. Of gross profits 338,770,000 marks were absorbed by administration expenditure and by taxes, which together amounted to 50.8 per cent on capital in 1925 as against 57.3 per cent in 1924. The net profits returned by all seven banks is 56,720,000 marks. As this sum is almost exactly the same as that of 1924, despite the extraordinary differences between business and currency conditions in the two years, the suspicion is strengthened that the banks have not shown all their profits.

In the present year the banks expect improved conditions. Both the capital market and the bourse have improved very much. In the matter of security the banks seem to be thoroughly sound, despite a continuing decline in their ratio of liquidity. This decline began a long time back, and since the beginning of last year it has been very considerable. At the end of 1925 the seven banks' resources of the first degree of liquidity, that is, cash, deposits with the Reichsbank and private banks, and bills and Treasury bills, totalled 2,361,580,000 marks against 1,864,000,000 marks at the beginning of the year; but the increased total was only 45.7 per cent of the liabilities as against 53.3 per cent a year before. The "de-liquefaction" of the banks, as it is called in Berlin, progressed almost to an extreme degree.

## *No Danger to Solvency*

THIS process, however, presents no danger to banking solvency. Credit conditions today are much more propitious than those prevailing a year ago. Almost the whole increase in the total of liquid resources consisted of bills and Treasury bills, which rose from some 926 to 1,375 million marks. Owing to the change in credit conditions, this increase is quantitative as well as qualitative. A year ago the Reichsbank was still rigorously inforcing Dr. Schacht's rationing of Reichsbank discounts, under which the total volume of outstanding discounts must not exceed the volume of April 1924. This system, which was designed in order to strengthen the leverage of the high Reichsbank discount rate, is still theoretically in force, though late last year Dr. Schacht increased the meagre ration by some 10 per cent. But in practice the rationing is not in force, for the good reason that the volume of discounts long ago fell far below the ration mark. At the end of 1924 the Reichsbank held 2,064 million marks of discounted bills; at the end of March 1926 only 1,167 million marks. Hence it is assumed the Reichsbank is ready to rediscount almost any conceivable quantity of commercial bank bills that could be presented in the present depressed industrial commercial juncture; and the commercial bank bills are therefore as good as cash. Certainly should business continue to revive and should a new credit pressure on the Reichsbank result, the commerical banks would be required to increase their liquidity, but there is little doubt of their will and their ability to do that in good time.

The past year leaves almost unchanged the one other feature in which the banks are insufficiently strong. Their capitals and reserves will be inadequate for the commercial and industrial financing of a country which has almost regained its pre-war productive capacity. The effects of the drastic scaling down of capital in 1924, which was made inevitable by the loss of old capital and reserves through the paper-mark depreciation, are still felt and will be felt even more when the present industrial stagnation is succeeded by normal activity.

It is almost certain that when that time arrives the banks will increase their capitalizations, and that, without sacrificing their independence, they will obtain a part of the new capital abroad. That means, in the United States. As a first measure, and with the aim of establishing preliminary

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# Foreign Government Bonds As Country Bank Investments

By GEORGE W. EDWARDS
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**Marked Increase in Volume of Time Deposits Brings a New Investment Problem. Foreign Bonds Do Not Involve Greater Risk Than American Industrials. Tests that Can Be Applied In Judging Worth of Overseas Securities. Misleading Indices.**

ONE of the most striking changes in the business of banking since the war has been the increase in time deposits. In the pre-war period time deposits represented less than 10 per cent of the total accounts of American banks. Today the banks in New York City and Chicago have 13 per cent of their deposits on a time basis, in the reserve cities 33 per cent, and in the non-reserve cities 46 per cent. Thus it is seen that the administration of time deposits constitute a problem particularly for the country banker.

This increase in the time deposits of the American banker has forced him to change the nature of his earning assets. On demand or checking deposits he often allows no interest, even on good accounts he rarely pays more than 2 per cent. However, on time deposits he must grant 3½, 4 and sometimes a higher per cent if he wishes to hold his own against the various institutions which are competing for the savings of his community. If he must pay so high a rate on time deposits, how will he place these funds so that they yield a return sufficient to him to justify the greater interest payment to his depositors? Since these holdings are not payable on demand but only on notice of a month or more, the banker need not concern himself so seriously with the matter of liquidity and hence he is able to convert these funds into fixed earning assets. He may put out a portion of his time deposits in mortgage money on local property and receive a satisfactory return. However, the banker is fully alive to the limitation of mortgages as investment for bank funds, and so is unwilling to place too much of his funds in this form of earning assets. Therefore, he has turned more to bonds as the most satisfactory form of investment for his time deposits. The importance of the bond account in American banking today is seen from the fact that in 1921 national banks held $4,000,000,000 in investments, while in 1925 these had increased to $5,725,000,000.

## *Do Foreign Investments Involve Greater Risks?*

THIS vast sum is placed largely in various forms of domestic investment, but of recent years a growing proportion has been carried in foreign securities. According to the statistics published in the Federal Reserve Bulletin, the interior banks are carrying a greater proportion of their investments in the form of foreign securities than the New York and Chicago banks. No doubt country banks, forced to pay a higher rate of interest on their time deposits, are attracted by the larger yield to be obtained on foreign securities. In considering such securities either as a purchase for himself or as a recommendation for his customers, the interior banker often is perplexed as to whether or not the higher yield to be obtained on foreign securities as against domestic issues is an accurate reflection of a greater risk.

Undoubtedly the spread in part is due to the uncertain political situation which exists in other countries as compared with the condition in the United States. The differential in yield can be explained primarily by the general unwillingness of investors to place funds away from home if they can find suitable commitments nearer at hand. In fact the actual history of foreign government securities in the pre-war period clearly indicates that they were among the safest forms of investment.

During the period of thirty years before the war, the average total amount of all government bonds outstanding amounted to $32,500,000,000, of which $126,000,000 or less than 4/10 of one per cent were in default. Within the same period American industrials were in default to the extent of 2.07 per cent and the American railroads to 1.84 per cent. If the Russian repudiation is not included the percentage of defaults on foreign government bonds listed on the London Stock Exchange is today only 1.6 per cent, a remarkably low proportion in view of the troublesome times since 1914.

## *Credit Factors of Foreign Governments*

FOREIGN government securities should be analyzed, not from a basis of prejudice, but solely from the economic standpoint. What tests can be applied in judging the value of foreign government bonds? These tests relate both to the factors of credit in the sense of the standing of the particular country under consideration and of the terms of credit as expressed in the individual bond. The factors of credit are universal and are concerned with both the character and capital of the prospective borrower. Has a nation been scrupulous in honoring its debts in the past, or neglectful in meeting its obligations to foreign creditors? Has its people shown a capacity for self government, or has its career been marked with frequent disturbances of one sort or another? These are questions which can readily be answered from the pages of history.

An appraisal of the capital factor or the assets of a government require close scrutiny. This element is often incorrectly judged by reliance on misleading indices. Too much emphasis is frequently found in circulars describing new foreign government issues upon the natural resources of these countries. These circulars occasionally dwell at great length upon the wealth of unmined ores, or the extent of uncut forests, or the immensity of the unharnessed water power which the country in question may possess. Such assets, while possessing potential significance for the future, are of little value in the present particularly if the country should be pressed to find money with which to meet the service on its external debt. Surely foreign creditors would not be willing to advance any more funds to such a defaulting country even for the purposes of developing natural resources in the vain hope of getting back their original investment.

## *Armament is Liability*

ANOTHER erroneous yardstick for measuring the credit of a nation is the extent of its military and naval power. As a matter of fact national credit really varies inversely with the size of the country's army and navy.

What then are the true tests of national credit?

In some cases the foreign governments own public utilities, as railroads or electric power plants, or revenue producing properties, as developed oil fields or tobacco factories which may in some cases be counted upon to yield a net return and not a deficit to the operating government. But the more certain asset of any government is its taxing power. This can best be appraised in relation to the total wealth of the particular country, or better still by the extent of the national income which serves as the base for government taxes. In this

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# "Ask Your Banker"

By JAMES RATTRAY
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**Lacking Facilities for Periodical Review of Foreign Bonds in Light of Current Developments, Many Bankers Decline to Recommend These Securities Which Offer High Yields. Need for More Enlightening Data. Must Keep Up With All Changes.**

"ASK your banker." "Investigate before you invest." These slogans of the Better Business Bureau are being broadcast throughout the country in a commendable campaign to stop the sale of fraudulent securities. Their effectiveness is known to bankers who are now being consulted more freely by their depositors regarding investments, but many bankers, especially those in sections remote from the larger city banks and investment houses, find themselves in a dilemma when asked for an opinion on certain issues, particularly those issued by foreign governments or corporations. Of course, in the absence of adequate and reliable data on which to base an opinion, the line of least resistance would be to recommend abstinence from foreign investment, and the purchase of domestic securities with which the banker may be familiar. Such advice might be termed conservative, and the depositor would not in all probability suffer any direct loss by following it, although he might lose indirectly by foregoing an opportunity for making a sound and profitable investment. However, advice based on fear rather than knowledge could hardly be regarded as the sound investment counsel that the depositor expects when he complies with the suggestion: "Ask your banker."

## *Opportunities In Foreign Bonds*

PROGRESSIVE bankers—their number is being recruited daily from the ranks of the American Institute of Banking—are actuated by a sense of duty to their depositors. If this duty requires giving advice on investments they must be equipped to express intelligent opinions on all classes of securities. In the case of standard domestic issues the problem is not so complex, because such securities are owned by practically all banks, and in purchasing them some investigation must have been made. Furthermore, it is comparatively easy to keep well informed concerning current events in this country, and to analyze their significance. In the case of bonds issued by foreign governments and corporations, which in recent years have constituted a very high percentage of new security offerings, the problem is decidedly more complex. Yet many of these foreign dollar bonds present the best investment opportunities for they are still selling at lower prices than the credit standing of the borrowers warrants, and such issues give the investor an opportunity for increasing the average return on his investment with reasonable prospects of appreciation in price, as well as for improving the geographical diversification of his holdings.

## *Current Information Necessary*

THE last annual report of the Comptroller of the Currency indicates that National Banks—and this doubtless reflects a similar condition in State Banks—are recognizing more clearly the investment possibilities in foreign dollar bonds. As of June 30, 1925, foreign securities held by National Banks aggregated $362,925,000, compared with $264,525,000 on June 30, 1924. This increase of more than 37 per cent represented the largest percentage of increase in any class of securities held. As the resources of National Banks are estimated at about 40 per cent of all domestic banking resources, it is reasonable to assume that our banking institutions have nearly $1,000,000,000 invested in foreign securities. Despite this impressive total, there are still many bankers even in the larger cities who hesitate to purchase such securities for their institutions, or to recommend them to their depositors. Not because they have investigated and concluded that they were unsound, but because they lacked the facilities for satisfactory investigation, and subsequently keeping informed regarding them. It has been the writer's privilege to consult with many bankers regarding their investments, and in almost every case a keen interest in foreign bonds was shown, as well as an appreciation of the economic necessity of such investments in our new position as a creditor nation. By analysis of specific foreign issues, it was possible to show that they met all the requirements of sound and conservative investments, but in many cases none were purchased, because the banker felt that he had not the facilities for watching his investment. Such an attitude was not illogical, for periodical review of securities in the light of current developments is as important, if loss is to be avoided, as investigating before one invests.

## *Sources of Information*

THE real problem for the banker who wishes to safeguard the funds of his institution, and to give his customers sound advice, is to obtain complete, reliable, and timely information. Investment manuals which are in most financial libraries are replete with historical and financial data on foreign countries. In the offering circulars of bonds sponsored by reliable investment bankers there is usually adequate information for forming an opinion as to the desirability of any particular issue at the time it is offered, but, if not, such information is readily available, through the offering house or other investment bankers. But, after the investment is made, how is the banker to know what political developments are taking place in the country whose bonds he owns, and what are the industrial and financial conditions? In the larger cities the daily press with world wide connections keeps its readers fairly well informed on happenings abroad, although sometimes there is a tendency to exaggerate unimportant events, and to misinterpret their meaning. However, a file of clippings from the leading New York papers, which can be maintained at a very small cost should prove valuable to holders of foreign bonds. The weekly financial publications also review the foreign situation, and such articles analyzed in conjunction with a study of fluctuations in foreign exchange and movements in international trade should be enlightening. In foreign affairs exchange quotations provide a very sensitive barometer.

## *Best British Publications Will Prove Informative*

THOSE interested in foreign bonds should also subscribe for authoritative financial publications issued in the countries in which they are interested. Unless one be a linguist, many of them would have little value, but in that event subscriptions to British financial journals, such as the Economist, Statist, and Economic Review, which are published weekly, would well repay the small outlay, for British investors are interested in the securities of practically every civilized country in the world, and the authoritative articles in these publications are based on experience as foreign investors that we do not yet possess. Then there are the publications of our own Federal Government on which a very large sum is expended annually, but which can be obtained by the public at a nominal cost, sometimes barely enough to cover postage. The reports of the Department of Commerce are particularly useful to those interested in foreign countries. In addition, valuable summaries of conditions abroad are to be found in monthly reviews of economic and financial conditions issued by many of the larger banks. An intelligent study of such sources of information does not entail a large expenditure of money; it does take time, but time so employed will be profitably spent.

# Banks Give Too Much Free Service

By M. E. HOLDERNESS
Vice-President, First National Bank, St. Louis

**Numerous Burdens Added Without Adequate Compensation. The Banker is Usually Urging Customers to Conduct Business on a Profitable Basis, and to Avoid Cut-Throat Competition, Yet the Banker is Last to Apply Precepts to His Own Business.**

FEW industries in the United States have undergone more of a transformation, during the past few years, than has banking. But as contrasted with the changes in other industries it is doubtful whether developments have redounded greatly to the benefit of the banks themselves.

The changes that have occurred have been not only in the character of the banking business itself, but also in its relation to the public. While this latter change has been characteristic of business in general, it has been particularly so in the field of banking. No other industry has done more to feature the matter of service and to develop so highly, because of peculiar competitive conditions, so great a variety of free services. While other lines also feature service, they endeavor, in this respect, to follow sound business practice and to secure a fair return for service rendered. In most other lines the endeavor was to increase volume to secure the benefit of quantity production and thus to lower costs, widen their markets and to give to the consumer the most possible for his money. The banker apparently interpreted this movement as synonymous with rendering free services of various kinds. Service to the public is one thing, but free service is another, and it is time that the banker realizes this fact.

> *"IT is something of a paradox that the banker who is constantly in touch, either directly or indirectly, with the modern up-to-date methods of business should be so slow in applying these methods to his own business. As a general thing the banker is usually advocating to his customers sound accounting methods, urging them to conduct their business on a profitable basis, to discontinue unprofitable operations, to avoid cut-throat competition and yet he is among the last to apply these precepts to his own business."*—M. E. HOLDERNESS.

## *Burdens Without Compensation*

DUE to certain fundamental changes in the very character of the banking business, numerous burdens have been added to the banker during the past two generations for which he has never received adequate compensation. In the earlier period banking was largely restricted to the purely deposit and loan function of the business and was of a much simpler character than it is today. Furthermore, bank loans prior to the universal use of the bank check (and that is not so long ago) were quite different from what they are today. Bank credit in the earlier days existed essentially in the form of bank notes. When a loan was made actual cash in the form of bank notes was, in large measure, paid out. Thus, the outstanding volume of bank credit was primarily in the form of bank notes, payable to bearer on demand and redeemable at the bank of issue, as contrasted with the modern deposit credit which circulates in the form of a check drawn by the individual depositor. Business in those days was not done primarily by check, but was more largely on a cash or long time credit basis. Consequently, many functions which are now of primary importance were then unimportant. The transit, collection and clearing activities of modern banks were still in their infancy. These are now among the principal routine daily activities and engage most of the employees of our banks.

Bank methods and operations under the older plan were entirely different from what they are today and the changes apparently came about so gradually that bankers themselves were slow to realize them. For example, prior to the rather universal use of the check, a bank deposit was somewhat different from the ordinary deposit at present. The modern problem of float and items in transit, or in process of collection, was then almost non-existent and did not constitute the important item of expense that it does at present. Deposits were usually made in the form of bank notes, and even though the issues of other banks, each had a definite value for which sum it was accepted. Some were at par, others at a discount, depending, first, upon the credit standing of the bank of issue, and second, upon the location of the bank and the time it would take to present the note, if cccasion demanded, for redemption.

As the bank check came into general use new demands and problems were placed upon the banker. As these developed, the expenses of doing a banking business increased rapidly. Strange as it may seem it is nevertheless a fact that except for an increase in the volume of business, the banker has received no commensurate reward for the enlarged and more extensive service he has been compelled to render. In this respect, however, the banker has no one but himself to blame. He was slow in realizing the changes that were occurring and loath to recognize them. Every banker is well aware of how long it took for the bankers to begin using even the simplest sort of common sense cost accounting methods. One has only to mention such a matter as the development of the modern analysis department of a bank to illustrate this point. Such a thing as analyzing each individual account from the profit and loss standpoint is still relatively new and not universally used. Yet, where it is in use, everyone knows that its discontinuance is inconceivable. Nevertheless in almost every branch of the banking business this same backward, narrow, ultra-conservative tendency has been manifest. It is something of a paradox that the banker who is constantly in touch, either directly or indirectly, with the modern up-to-date methods of business should be so slow in applying these methods to his own business. As a general thing, the banker is usually advocating, to his customers, sound accounting methods, urging them to conduct their business on a profitable basis, to discontinue unprofitable operations, to avoid cut-throat competition, and yet he is among the last to apply these precepts to his own business. If the bankers of this country would practise 50 per cent of the sound business policies which they preach they would not today be worrying themselves grey over the problem of how to maintain established dividend payments to their stockholders.

IT is high time that the bankers of this country should take cognizance of conditions in their own business. Despite the fact that banking is a fundamental industry, and, on the whole has been keeping pace with the natural growth of the country, ably and capably meeting the many financial and credit requirements of business, it nevertheless has, in recent years, been operating at an ever decreasing rate of return. In view of the natural inherent risk in the business, the rate of return on capital invested in the banking business has reached a point, in many sections of the country,

where it is nothing short of pitiful. While it is true that profits on the part of certain individual institutions, in certain sections, have been satisfactory, this has been brought about not so much as a result of their ordinary commercial bank operations, as it has through the development of certain side lines or auxiliary financial operations which have yielded large returns.

## *Earnings East and West*

ONE has only to study the report of profits of the member banks of the Federal Reserve System for the years ending June 30, 1924 and 1925 to realize this fact. While it is true that the average profit per $100 of capital, surplus and undivided profits of the banks of the country, as a whole does not appear unusually low, a more careful study of the facts is very enlightening. To get the true picture we must examine the situation existing in the various Federal Reserve districts. This study of the Federal Reserve shows that, on an average, the banks east of the Mississippi, during the past four years, earned a return of 8.82 per cent on invested capital, whereas the banks west of the Mississippi earned only 5.52 per cent. In 1924 the western member banks earned only 4.85 per cent and in 1925 they earned 5.66 per cent. Generally the West is thought of as a section of the country where interest rates are high and the profits of bankers correspondingly large, yet during the past two years, when conditions the country over were generally prosperous, and last year were unusually so, capital invested in the banking business in the western sections of the country, averaged less than 5½ per cent. That such a return is inadequate, not only from an investment standpoint, but in view of the risks involved in the business, is quite patent. Not only that but it is far below the average return on capital invested in other lines of business. A recent study of the return earned on the invested capital in nineteen different classes of business shows the average rate last year to have been 7.49 per cent, with earnings in some lines averaging well in excess of 10 per cent.

In view of these facts it would appear high time for the bankers to make a careful investigation of the causes which underlie the existing depression in their own business and begin taking measures to correct the situation. If they would give careful and serious consideration to the policies and business methods which they have been pursuing in recent years, they would soon find a solution of their present unsatisfactory earning status. Such an introspective study would show, among other things, the following facts:

## *"Service" Misinterpreted*

FIRST, that the banker has misinterpreted the word "service." So far as the fundamental importance of the modern business conception of service is concerned, no issue can be taken. However, it is equally certain that sound and satisfactory service is not based upon its being necessarily free. We do not have to question the great benefit which has come from an emphasis upon service, but we must be careful not to overemphasize any temporary benefits to the public which may accrue at the expense of permanent welfare. After all a particular business, which is conducted on safe and sane lines, or a particular life which is lived according to high individual standards, although it may appear somewhat restricted and selfish, yet in the end may give quite as large a contribution to social welfare as when some preconceived ideas of public rights, or of duties to the public are allowed to take precedence over the individual judgment as to how the business should be conducted or as to how the individual life should be lived.

Second, when there was ushered in this new day of service as the watchword in business, it brought with it the virus of salesmanship, advertising, emphasis upon the volume of business or quantity of business rather than quality. The banking business became subjected to all kinds of high pressure salesmanship with a high degree of competition among the various banking institutions which not only has resulted in many kinds of evils and weaknesses in the conduct of particular banks, but what is of equal importance, it has made cooperation among the banks difficult and therefore the opportunity rendering real permanent service, through the conduct of the business on a high plane, has become difficult. The importance of this point cannot be over-emphasized. The public never has understood, and perhaps never will understand, the real function and place of the bank in a community. It has, in the past, and probably will continue in the future, to impute to banks huge profits and more power and control than they really do exercise. It is a commonplace assumption, on the part of the public, that in some mysterious way the banks control credit and that the banker holds within the hollow of his hands the destiny of business men and the industrial prosperity or poverty of the community. Bankers may continue to preach, as they have in the past, that a commercial bank does not create credit, or money, or control prices, but for some reason, the public apparently refuses to think of the bank simply as a dealer in credit, and that one of its most important services consists of exchanging the credit of the individual, which has only limited acceptability, for its own credit which has general acceptability.

## *Time for Frankness*

THIRD, competition in American banking has reached a point where it may be properly inquired whether some of the results, disguised in the name of service to the public, should not be frankly faced and inquiry made whether they are logical or a valuable adjunct to modern commercial banking. The importance of this is at once manifest when we take into consideration the fact that there are approximately 30,000 competing banks in this country. The number of banks has grown largely under the mistaken belief that the business is highly profitable. As a consequence, during the past quarter of a century, with the rapid growth in population and industrial development, there have been organized thousands of banks which probably never should have been organized. Had it not been for the intensive competition, many of the practices and the various classes of service which are now rendered by banks would not have developed. While much can undoubtedly be said in defense of competition, there are limits to its benefits. As a matter of fact a study of history shows that where competition is keen it invariably develops into the cut-throat type, and when such a policy persists for any length of time, the public, who at first believes it is being benefited, finds that it, too, is a loser. This type of competition has undoubtedly developed among bankers in many sections. It can be found anywhere from the small town which has two banks, where there ought to be only one, to the large metropolitan district that has 100 banks, where 50 would be sufficient to render the public an adequate service. Competition in the banking business has, in many places, become so keen that there are few businesses in the United States where there is less of a willingness to exchange information or to cooperate than in the banking business.

## *Waste in Promoting Thrift*

THE Federal Government has had to pass laws such as the Sherman Anti-Trust Act and to establish commissions such as the Federal Trade Commission, to lay down the limits beyond which cooperation will not be permitted among industries in the United States. But the American bankers do not need an anti-trust act or a Federal Trade Commission to forbid them from cooperating. They must be trusted at all times, in season and out of season, to engage in cut-throat competition and refuse to cooperate and to afford par excellence the modern illustration of the Kilkenny cats which are continually trying to eat each other up. What has been the result of all this competition? Useless duplication in many kinds of banking service. Every bank maintains that it is interested in thrift and savings. Are there many illustrations in the United States where the banks of any large city join in a public campaign to inculcate thrift? Instead of that each bank spends large sums in advertising savings for themselves.

Another effect of the excessive competition in banking is illustrated in the case of interest on deposits. Practically thirty-five cents out of every dollar of gross income of banks is now paid as interest on deposits. Practically every commercial bank has innumerable accounts without which it would be much better off. They are purchased accounts and the bank itself pays a price for the privilege of having a customer.

Then, too, competition has expressed itself in offering all kinds of services until the modern bank in the large metropolitan districts has become something like a department store, except that instead of selling service it gives it free. Banks now keep securities and collect coupons free, maintain travel bureaus, supply free check books and render a dozen and one kinds of services which have no inherent place in sound commercial banking service.

Not only has the competition expressed itself in these various detailed ways, but what is even worse, from the standpoint of public welfare, it has frequently expressed itself in the poor granting of credit. Many

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# New Banking Laws in Nine States

**New York Places Bank Taxation on Income Basis. New Jersey Eliminates Tax on Transfer of Property of Non-Resident Decedents. South Carolina to Adopt New Banking Code. Special Efforts to Be Made to Promote Uniform Fiduciaries Act in States.**

WHILE only nine state legislatures have thus far been in session during 1926, new banking laws of some moment have been enacted in several states, the Committee on State Legislation reported to the Executive Council. In New York, Mississippi and South Carolina a number of important proposals have become law and legislation of some moment has been passed in New Jersey, Massachusetts, Virginia and Rhode Island. In Kentucky, the legislature made only a few slight changes in the banking laws, dealing with the fees of examiners and increasing the number, but took no action of general interest to the banks. In Washington, a law was passed legalizing the action of a bank in paying a draft signed by the president or other officer of a corporation to his personal order.

In New York State, following the passage of the federal law permitting states to tax the income of National banks, the system under which banks are taxed was changed, so that, beginning with next year, banks will be placed on a 4½ per cent income tax basis, the same as is now imposed upon business corporations. The share tax and moneyed capital tax have been repealed to take effect on March 31, 1927.

THE principal legislation in New York dealt with savings banks. The legal deposit limit in savings banks was increased from $5,000 to $7,500, and the field of trust accounts was broadened. Permission to operate safe deposit vaults, hitherto granted to savings banks in cities of the first class, was made state-wide. Savings banks were empowered to purchase group life insurance for their employees. The move to broaden the field of legal investments by including certain selected electric light and power, gas and telephone bonds, failed, however. A bill affecting the municipal investment law, extending the period of city default from 90 to 120 days where there is a population of more than 40,000, was enacted.

A long stride in overcoming the tax evil on non-tangible inheritances was overcome when New Jersey eliminated the tax on the transfer of the personal property of non-resident decedents. The law establishing the department of banking and insurance was strengthened. The laws governing banks and trust companies were amended so that the place where the business is to be carried on must be specifically designated, and no institution will be permitted to remove from the address given without the written approval of the Commissioner of Banking and Insurance.

Some changes were made in the New Jersey law defining what securities are legal investments for savings banks and the law covering the direct descent of real estate was altered.

IN Massachusetts, three branches of trust companies in contiguous towns were authorized, after the Bank Commissioner had given his opinion that no adequate banking facilities existed there. This was done by special amendment to their charters and not by general legislation, but it is regarded as representing a slight change in the legislative point of view. A measure was passed to facilitate transfers of stock by trustees. Savings banks were empowered to sell travelers' checks and to transmit them to another state or country. To square the Massachusetts legislation with the holding of the United States Supreme Court in the Frick case, provision was made for the taxation of tangible personal property located in Massachusetts belonging to non-resident decedents. A bill was enacted relative to the issue of capital stock against surplus by trust companies.

In Virginia, the legislature provided that no bank or trust company might establish a branch, except that the State Corporation Commission might authorize banks having a paid-up and unimpaired surplus of $25,000 or more to do this. No branch may be operated or advertised under any other name than that of the identical name of the home bank, without special permission from the State Corporation Commission and unless this different name clearly indicates that it is a branch bank of the home bank. A committee was authorized to codify the banking laws of the state. Restrictions were thrown around the issuance of certificates of deposits and other negotiable instruments by banks and trust companies, and limitations were placed on the issue of acceptances and letters of credit by banks.

IN Mississippi, a law was passed permitting guaranteed banks, under certain conditions, to receive deposits in excess of ten times the capital and surplus, extending the limit to fifteen times when permission is given by the Superintendent of Banks. With the permission of the Superintendent, banks may exercise the functions of trust companies. Another measure provides that where an interest rate is allowed by statute which would subject the evidence of indebtedness to taxation, such interest rate shall not, in any suit, be held to subject the evidence of indebtedness to taxation by reason of the collection or payment or contract for payment of earned interest at statutory or prescribed maximum rate per annum with semi-annual rests; and further provides that the maximum rate of interest may be charged on all loans where the principal and interest both fall due at the same time in less than one year after the date of the note evidencing the same. Two bills sponsored by the American Bankers Association in its program for uniform state laws covering certain subjects were enacted: The measure authorizing the forwarding of paper for collection direct to the payor and the bill punishing burglary with explosives.

In South Carolina, the legislature by a joint resolution directed the Governor to appoint a Banking Code Commission and prescribed its powers and duties. Laws were also passed to regulate the granting of charters of state banks and classifying the minimum capital, according to population. The law governing the eligibility of bank directors was strengthened and a further act was passed to provide for the recording and indexing of assignment of mortgages upon real property.

THE Committee on State Legislation urged that special efforts be made to promote the enactment of the Uniform Fiduciaries Act by the legislatures which convene in 1927. Nine states—Colorado, Idaho, Louisiana, Nevada, New Mexico, North Carolina, Pennsylvania, Utah and Wisconsin—have adopted it. "It appears that banks in many states are doing business under a considerable amount of risk in connection with the receipt on deposit and payment of checks drawn payable to agents, officers of corporations and other fiduciaries whenever such checks are deposited to the personal credit of the fiduciary," W. D. Longyear, of Los Angeles, chairman of the committee, declared. "An impracticable duty of inquiry is placed by the courts upon the banks in connection with these transactions, and the Uniform Fiduciaries Act was expressly designed, after years of careful preparation, to protect the banks against such undue risks.

"It is doubtful if the wide scope of the meaning of the title of the Act is realized by the great majority of our members who may not have given the subject serious consideration.

"The Act defines 'Fiduciary' as including 'a trustee under any trust expressed, implied, resulting or constructive, executor, administrator, guardian, conservator, curator, receiver, trustee in bankruptcy, assignee for the benefit of creditors, partner, agent, officer of a corporation, public or private, public officer or any other person acting in a fiduciary capacity for any person, trust or estate.'

"The uncertain condition of the law on this subject in many states and the impracticability of requiring banks to make inquiry in case of every check drawn by an officer of a corporation or by an agent, or other

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# Produce Business Further Stabilized

By C. B. SHERMAN
U. S. Department of Agriculture

**Two Thousand Persons or Firms in the Fruit and Vegetable Trade Have Entered Into an Agreement to Adhere to Proposed Standard Trading Rules. A Help to Both Growers and Merchants and a Great Aid to the Producer's Credit.**

"ENTERING into partnership with Uncle Sam" is the popular name for the latest line of epoch-making work inaugurated by the United States Department of Agriculture. And more than 2000 individuals and firms have expressed a desire to enter this partnership, within a few weeks of the announcement of the plan.

The plan provides for agreements or contracts between the Department and individual members of the fruit and vegetable trade to adhere to proposed standard trading rules. Individual shippers, growers associations, dealers, brokers, commission merchants, and other distributors who handle fresh fruits and vegetables in wholesale quantities are eligible. Meanwhile, the Department offers to act as arbitrator of a limited number of controversies, in order to investigate the character and variety of the causes of these disputes and to establish precedents for their settlement.

## A *Business Innovation*

NO man has ever before been able to say that the government of the United States was a partner in his business. But now the Department of Agriculture actually proposes to give each of his signed partners a registration number and the right to use an approved seal or trade device on his business stationery showing that he is cooperating with the Department.

The standard trading rules, already being followed by many of the best elements in the organized part of the fruit and vegetable trade, are the basis of this new partnership, with the following additions:

First, it is provided that official grades shall be used to describe products to which they are applicable, unless they are sold under well-known brands based upon written specifications. The second important addition provides that disputes may be referred to the Secretary of Agriculture for arbitration if the parties to the controversy do not agree upon arbitration by any other method. The third important addition provides for investigation of grievances in connection with purchases and sales, including those made through commission merchants and brokers.

The Department hopes that it may not be necessary to maintain permanently an official arbitration board, even though this board will be composed of men already actively engaged in other fruit and vegetable work of the Department. It does not propose to set a time limit on this activity and is ready to handle a sufficient number of cases to demonstrate its idea as to the interpretation and application of these standard rules. Whenever a sufficient number of cases have been arbitrated to establish comprehensive precedents for the guidance of other arbitrators in handling all classes of cases likely to arise, it is hoped that the industry may be able to set up its own unified machinery for the adjustment of such controversies, possibly through the appointment or permanent employment of a distinterested board.

After investigation of complaints, the Department will suggest to the party adjudged to be at fault what reparation he should make or what action he should take in order to remain in good standing. If he refuses to comply, the Department reserves the right of cancelling its agreement with him and making public the reasons for the cancellation.

## *Result of Real Demand*

FOR some time there has been a growing conviction on the part of the best elements in the trade that something should be done to strengthen the hands of those who would uphold the ethical standards of the industry. Lately the demand for some sort of help from the Department of Agriculture has been active and continuous, but no one who really understood the situation wanted mandatory legislation.

After several preliminary proposals of the Department had been considered at length by the trade organizations, the Secretary of Agriculture called together a representative group, selected from every important trade association, and with their aid the form and substance of the proposed cooperation of the government with the individual produce dealer were worked out. Since last June no subject has had such earnest discussion in the meetings of the trade organizations and the sentiment, although not unanimous, has run steadily in favor of the proposal.

Now the offer is definitely made by the Department to the public, and the 2000 immediate applications are the result with more applications coming in daily. Large operators and small see good advertising in the slogan, "Uncle Sam Is My Partner."

Practically every state in the Union is represented in the list of trade members who have signified their intention to sign these agreements with the Department. New York is represented by more than 200 names, California 150, Illinois 100, and Washington State 100. They include many of the leading members of the fruit and vegetable industry. On the other hand the plan is freely referred to as a godsend to the small shipper and to producers in regions of relatively small production.

Such growers are often forced to consign, since official inspection is not available at their shipping points and it is difficult for them to negotiate f.o.b. sales. For the first time these shippers will have a list of dealers and commission merchants to whom they can ship with assurance that in the event of proven fraud the offender will have more to lose than they, and this without recourse to the courts. Shippers everywhere can know exactly which receivers in each market have signed with the Department, and cooperating receivers will be able to locate every shipper who has bound himself by the official trading rules.

## *Produce Business Enormous*

FAIRLY accurate records of shipments on some 30 of the principal fruits and vegetables show an average annual movement in recent years of about 950,000 cars. The total movement is probably 1,000,000 cars or more per annum. With such prices as have prevailed in the season of 1925-26 for apples, citrus fruits and potatoes, the average value of all cars of fresh fruits and vegetables when placed for unloading at market terminals is not less than $1,000, making an annual business of over $1,000,000,000 in carlot valuations.

This fruit and produce business, enormous as it is, has largely developed within the memory of men now living. Its growth continues to be spectacular. Total acreages of some of the vegetables have doubled in the past six years. In some states the acreages of some of the perishable crops have more than trebled during that period. With this immense expansion, which inevitably meant the use of distant markets for a perishable crop, it goes without saying

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*Avalon Bay, Catalina Island—The Magic Isle*

# The West Is Calling You

## By W. R. MOREHOUSE

**Vice-President, Security Trust & Savings Bank, Los Angeles**

THE call of the West this year carries with it an almost irresistible appeal. Never before in the history of western conventions has so much been offered in special attractions, and so much that is unusual.

The Fifty-second Annual Convention of the American Bankers Association at Los Angeles October 4-7 is, of course, the biggest attraction of them all. It opens the way for that long deferred western trip to the Pacific Coast.

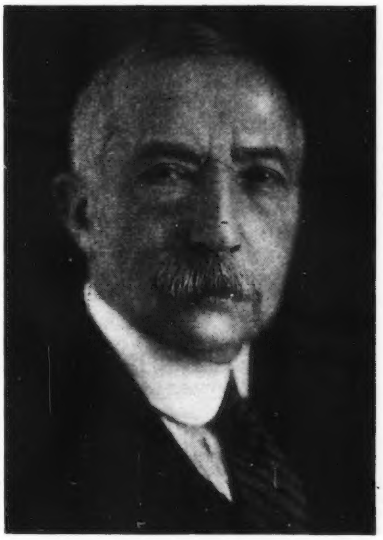
At Los Angeles, the convention city, twenty committee chairmen with their committeemen numbering several hundred are completing arrangements for your comfort and pleasure.

Southern California climate in October is ideal for golf. Approximately fifty golf clubs will keep "open house" during convention week, giving a wide range of courses to choose from.

DURING the convention there will be a motion picture studio day for visiting bankers. On the committee are some of the leading producers of pictures. Each is desirous that visiting bankers become better acquainted with the industry. Ordinarily these studios are closed to visitors, but during the convention they will be open to bankers. Each of the studios visited will be working on some important picture which will afford an exceptional opportunity to see motion pictures in the making.

Especially interesting to those who live inland will be a trip to Catalina Island —a fifty-mile sail on the blue waters of the Pacific. A palatial steamer has been chartered for the occasion, with music for dancing and other entertainment during the voyage. A swim in the quiet and crystal-like waters of Avalon Bay for those who enjoy aquatic sport, fishing for those who are anglers, and for those who have never seen the submarine gardens there is in store a treat beyond description. These submarine gardens are gorgeous in their beauty.

In addition to the attractions in and near the Convention City the bankers in seven other western cities will also keep open house. In fact, the delegates are to be the guests of the West. Bankers' sightseeing committees have been organized in Salt Lake City, Spokane, Seattle, Portland, San Francisco, Oakland and San Diego. Never before has the banker who makes a western trip had such a great opportunity to see the West from Canada on the North to San Diego on the South as the guest of other bankers. In any of the cities mentioned bankers will meet your train or call for you at your hotel and take you on sightseeing trips as their guest. This is the year for you to arrange for stop-overs, and see the West. All that you will need to do is to advise the chairmen of the Sightseeing Committees the route you are traveling and time of your arrival, or if remaining over any length of time in any of the cities mentioned, give the name of your hotel and the day and hour you will be ready to go sightseeing.



*J. F. Sartori, General Chairman, Los Angeles, A. B. A. Convention Committee; president, Los Angeles Clearing House Assn.; president, Security Trust & Savings Bank*

IF stopping over in Salt Lake City you should notify R. C. Wilson, assistant cashier, National Copper Bank of your plans; in Spokane, W. T. Triplett, vice-president, Spokane & Eastern Trust Company; in Seattle, J. T. McVay, president, Metropolitan National Bank; in Portland, E. H. Sensenich, president, West Coast National Bank; in San Francisco, J. F. Sullivan, Jr., assistant cashier, Crocker-First National Bank; in Oakland, A. W. Moore, vice-president, Oakland Bank; and in San Diego, E. J. Belcher, Jr., president, First National Bank.

That hotel rates will not be raised for the convention is assured, for one of the first things which the Southern California Hotel Men's Association did upon being advised that the bankers were coming to Los Angeles was unanimously to agree among themselves that rates would not be increased, and they so advised the American Bankers Association.

ANOTHER inducement for making that western trip this year is the low railroad rates in effect. Convention dates permit taking full advantage of summer rates, which do not expire until October 1, returning not later than October 31. This will enable you to take advantage of these low rates, arriving in Los Angeles for the opening of the convention October 4, and permitting you three weeks after the Convention in which to return home.

# Opinions of the General Counsel

By THOMAS B. PATON
General Counsel American Bankers Association

## National Bank as Trustee

*A NATIONAL bank exercising trust powers has the right to hold and to vote its own stock, received as trustee in connection with the estate of a decedent or in cases of living trusts which the bank is authorized to execute and Section 5201 U. S. Revised Statutes which prohibits a national bank from being the purchaser or holder of any of the shares of its own capital stock has no application to shares held by the bank as trustee—In New York where there is a similar prohibitory statute applicable to trust companies, such statute is not deemed applicable to shares of stock of a trust company held by it as trustee but, although the right to hold and vote such stock is asserted, there is a difference of policy as to holding such stock in the absence of specific instructions, and it is the general policy not to vote such stock unless for some special reason or because of some specific instruction.*

From Ohio:—May a national bank having general trust powers under the laws of the state in which it is doing business and properly authorized by the Federal banking authorities to conduct a trust department (specifically this bank operating in Columbus, Ohio) receive and hold as trustee shares of its own bank stock? This question arises in connection with estates in which this bank is named as executor and trustee where shares of the stock of this bank form a part of the trust estate, and also has arisen in cases where persons desire to create living trusts, transferring to the bank as trustee certain shares of our own stock.

If the bank may receive and hold as trustee shares of its own stock and disburse the income arising therefrom and eventually the stock itself as directed by the instrument creating the trust, may it exercise any voting power with respect to such shares of its own stock held in a trust capacity?

If the bank may receive and hold as trustee shares of its own stock, but in your opinion may not exercise the voting power incident thereto, may the person creating the trust by provision in the trust department vest the voting power rights in some person other than the bank, while the title to the shares is held in the name of the bank as trustee?

It is possible you may have had occasion to investigate and express opinion on the above questions, and if so we will appreciate a citation to your previous opinion.

1. In my opinion a national bank, duly authorized to exercise trust powers, has the right to receive and hold as trustee, shares of its own bank stock, either in connection with estates of decedents where the shares form a part of the trust estate, or in cases of living trusts which the bank is authorized to execute.

Section 5201 U. S. Revised Statutes provides:

"No association shall make any loan or discount on the security of the shares of its own capital stock, nor be the purchaser or holder of any such shares, unless such security or purchase shall be necessary to prevent loss upon a debt previously contracted in good faith; and stock so purchased or acquired shall, within six months from the time of its purchase, be sold or disposed of at public or private sale; or, in default thereof, a receiver may be appointed to close up the business of the association, according to section fifty-two hundred and thirty-four."

This provision which dates back to the Currency Act of 1864, half a century before national banks were granted trust powers, and which prohibits a bank from owning and holding its own shares, cannot I think be construed as a restriction upon the right of the bank to receive and hold such stock in a fiduciary capacity. Such holding is not in its own right but for someone else, and the reasons which underlie the policy of forbidding the bank to buy in and hold its own stock do not apply. The point has never been specifically decided nor has the Federal Reserve Board made a specific ruling upon this particular point. But a general ruling made January 7, 1919 (F. R. Bull. Feb. 1, p. 143), bears an analogy. It provides: "Neither the provisions of the National Bank Act nor of the Federal Reserve Act which relate to investments that may be made by national banks of their own funds have any application to investments that might be made by a national bank of funds held in trust which do not belong to the bank." In other words, the Federal Reserve Board recognizes that the restrictive provisions of law applicable to national banks have no bearing where the bank acts in a trust capacity. I think, therefore, the conclusion is warranted that a national bank has the right as trustee to hold its own shares of stock both in cases of decedents' estates and living trusts.

2. To hold the stock as trustee carries the right to vote the stock. Section 5144 U. S. Revised Statutes provides, however, that "no officer, clerk, teller or bookkeeper of such association shall act as proxy" and the word "officer" includes "director" according to ruling of the Comptroller of the Currency. The bank, therefore, would be obliged to nominate as proxy to vote the stock someone outside its official force.

3. Section 190 of the Banking Law of New York relative to trust companies contains a provision prohibitory of ownership of stock similar to Section 5201 U. S. Revised Statutes. As it seemed entirely probable that similar questions must have many times arisen in trust company practice, interviews were arranged with a number of officers of trust companies in the city of New York, as a result of which the following information was obtained from five trust companies.

(1) *Trust Company No.* 1. Recognizes its right to hold its own stock as trustee but does not ordinarily vote the stock. It would, however, vote the stock by proxy whenever desired by the beneficiary.

(2) *Trust Company No.* 2. Would dispose of the stock unless expressly directed by the trust instrument to hold it and reinvest the dividends or pay them to beneficiaries. It would not vote stock held as trustee, whether its own stock or any other stock, unless special reasons required it. Although its policy would be to dispose of its own stock held as trustee, this would await a fitting opportunity and depends upon the condition of any particular estate.

(3) *Trust Company No.* 3. Received an opinion from its attorney some years ago, that it had a right to hold its stock as trustee. Its policy, however, is to dispose of the stock and invest in other desirable stock. It does not hold the stock or vote the stock unless directed.

(4) *Trust Company No.* 4. Has no set rule. Whether the stock will be held or sold depends upon instructions and the condition of the individual estate. Sometimes such stock is voted and sometimes not; but never for officers of the company.

(5) *Trust Company No.* 5. Said the question had never been brought up but saw no objection to a trust company holding or voting as desired its stock held in trust.

The result of this inquiry indicates that among the New York Trust Companies interviewed there appeared to be no question as to the right of a trust company to hold or to vote its own stock held in trust. However, a difference of policy was indicated as to holding such stock in the absence of specific instructions. It appeared, furthermore, that the general policy is not to vote the stock unless for some special reason or because of some specific instruction.

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## Joint Certificate of Stock

*A BANK questions the desirability of issuing a certificate of its stock in the joint names of mother and son or to any two persons jointly other than husband and wife.* Opinion: *Except in the case of stock issued to husband and wife which would create an estate by the entireties and be exempt from the claims of creditors of either during life and upon the death of one, belong to the survivor, it would seem an undesirable practice (unless in exceptional cases or unless the bank is legally required) to issue stock to two persons jointly because of uncertainty and complications as to ownership upon death of one and further complications which might arise where both parties are living, in case of subjection to claims of creditors of one of the parties or disposal of his interest by one; and in all such cases, including stock issued to husband and wife there would be the further necessity of arranging who should vote the stock and receive dividends.*

From Pennsylvania:—We have just received a request from one of our shareholders that a certificate of stock be made in the joint names of herself and her son, and I have hesitated to do this as a complication might arise in case of the death of either of them and the settlement of the estates.

This good woman has the idea that because a husband and wife may pass a certificate to the survivor through joint ownership during the lifetime that the same rule would apply to mother and son, and in my reading of the law I fear she may be mistaken, and as this is the first time this question has been presented, I would request an opinion from you on same.

### Joint Certificate of Stock

I have yours of March 12. Your point is well taken that inconveniences or complications might follow the issuance of a certificate of stock in the joint names of mother and son or in the joint names of any two persons, other than husband and wife, sufficient to challenge the desirability of compliance with a request to issue stock in such form. These inconveniences might arise not only in case of death of one, but while both parties are living. Let us ex-

amine the law, particularly as we find it developed in Pennsylvania.

**Stock Issued to Husband and Wife**

Stock issued in the joint names of husband and wife would constitute, not a joint tenancy or a tenancy in common, but an estate by the entireties and upon the death of one, the stock would belong to the survivor. Parry's Estate, 41 Atl. (Pa.) 448. No inheritance tax would be assessable, because the whole estate continues in the survivor from the beginning and the survivor does not succeed in the moiety of the deceased. In re Leach's Estate, 128 Atl. (Pa.) 497. Furthermore, during the lifetime of both, the stock would be exempt from execution and sale by a creditor of either husband or wife separately. Beihl v. Martin, 84 Atl. (Pa.) 953; 42 L.R.A. (N.S.) 555 and note.

There would, therefore, be no particular inconvenience to the bank in issuing a certificate of stock jointly to husband and wife, except in connection with an arrangement as to who should vote the stock and receive dividends.

But assume a certificate of stock is issued jointly to mother and son or to other parties jointly, not husband and wife. At common law, this would create a joint tenancy with the incident of survivorship. But by Act of the Pennsylvania Legislature March 31, 1812, the legal presumption of joint tenancy with right of survivorship was taken away, leaving it open to the parties, however, to provide a joint tenancy by will, deed or agreement in any form of words sufficient to express an intent to create a joint tenancy and overcome the presumption arising from the statute. In re Leach's Estate, supra; in re McCallum's Estate, 60 Atl. (Pa.) 903.

Assume then a certificate of stock is issued to A and B, other than husband and wife. This of itself creates no presumption of joint tenancy. If one of the parties dies, the bank cannot safely issue a certificate to the survivor but the question of ownership may become complicated and the bank entangled in litigation between conflicting claimants. The survivor may, of course, be able to prove a joint tenancy was created at the time of issue of the stock. For example, in Leach's Estate, supra, a brother and sister owned a library under an agreement which provided that "our library and collections are to be our joint property and to become the property of the survivor." The brother died. In this case it was held a joint tenancy was created when the library and its additions were secured, the sister's rights then accrued and did not pass to her by succession from him but by reason of her contract of purchase. Under the circumstances no collateral inheritance tax was held chargeable.

But in the case of bank stock, unless there was filed with the bank some agreement expressly creating a joint tenancy with right of survivorship in the stock certificate, uncertainty would arise upon the death of one as to the ownership. Furthermore, during the lifetime of both, the interest of one of the parties even though he be a joint tenant, is subject to the claims of creditors. Execution on a judgment against one joint tenant severs the joint tenancy. Davidson v. Haydom, 2 Yeates (Pa.) 459; and a joint tenant may sever the joint tenancy by assigning or pledging his share. Simpson v. Ammons, 1 Binn. (Pa.) 175.

**Voting Joint Stock**

Where stock is issued to two persons together, a power of attorney or proxy is necessary to vote the stock. In re Pioneer Paper Co, 36 How. Pr. (N.Y.) 111. Neither party can vote such stock without the consent of the other. Hey v. Dolphin, 36 N. Y. Supp. 627.

**Conclusion**

While it is perfectly lawful to issue a certificate of stock to two persons jointly and while, possibly, there may be cases where a bank or other corporation can be compelled to issue stock in this form to evidence the property rights of the parties, still, for the reasons above given, wherever it is a matter of the bank's discretion, it would seem an undesirable practice to issue stock to two persons, except possibly in the case of husband and wife, or some other exceptional case, because of the complications as to ownership likely to ensue in case of death of one, depending upon whether or not there exists a joint tenancy with right of survivorship and further complications, while both parties are living, growing out of the power of one to dispose of his interest or its subjection to the claims of creditors also—and this applies as well to stock issued to husband and wife —because of the necessity of arranging as to who should vote the stock and receive dividends.

# New Books

GETTING AHEAD IN THE BANK. By Herbert Dee Ivey. 163 pages. $1.50. Published by The Bobbs-Merrill Company, Indianapolis.

This is a book of tips to those filling subordinate positions in banks, giving them information about banking customs and practices that will help them to do their respective jobs better. Written by a Los Angeles banker, who worked his way up from messenger to vice-president, the book is filled with practical and pointed suggestions on how the bank clerk can keep his way from trouble and mistakes.

I'LL NEVER MOVE AGAIN. By Fitzhugh Green. 209 pages. $2. Published by E. P. Dutton & Co., New York.

One who confesses that he has moved fifty-two times naturally has accumulated a bit of wisdom about leases, crating furniture, firing cooks and opening up bank accounts. In a humorous style, the author imparts some of these important details to the reader. There is one chapter based on Rule 45. Whenever you move, start an account at your neighborhood bank.

THE CLEARING AND COLLECTION OF CHECKS. By Walter E. Spahr. 581 pages. $7.50. Published by the Bankers Publishing Co., New York.

All phases of the clearing and collection of checks are covered in this comprehensive book, which deals with the subject in a historical, analytical and practical way. It treats in detail the establishment of the mechanism set up by the Federal Reserve System and discusses the par collection controversy showing in what respects it has hampered the development of the new system. The final chapter is given over to a lengthy résumé of the present system for clearing the nation's checks.

THE OFFICE OF THE COMPTROLLER OF THE CURRENCY. By John Gilbert Heinberg. A service monograph by the Institute for Government Research. 79 pages. $1. Published by the Johns Hopkins Press, Baltimore, Md.

This is the thirty-seventh monograph of the United States government published by the Institute for Government Research. It covers the history, activities and organization of the Federal agency which has jurisdiction over the operations of the National banks of the United States.

THE BUREAU OF THE MINT. By Jesse P. Watson. 90 pages. $1. This is another monograph in the same series. After giving the history of the Bureau of the Mint, it outlines its activities, and discusses its publications.

INVESTMENT TRUST ORGANIZATION AND MANAGEMENT. By Leland Rex Robinson. 448 pages. $6. Published by the Ronald Press Co., New York.

An explanation from the American standpoint of this long established British financial trust, which is being adopted in this country. It explains in detail how the investment trusts are organized, financed, conducted and what advantages they offer. It deals not only with the pure investment trust but with the American variations—the financing companies, the bankers' shares companies and the public utility holding companies maintaining distribution of risk in the employment of their capital.

# Cost of Trust Business

THE cost of soliciting trust business varies in different cities and in various institutions. Recently, however, an effort has been made by several trust companies to ascertain what would be a proper ratio of expense.

A trust company in Detroit found, over a period of years, that it cost 3.8 per cent of the worth of the will or life insurance trust to obtain this business. In these costs were included the representatives' salaries, automobile upkeep, a fee for the attorney who drafted the documents and other incidental expense. No allowance was made, however, for an overhead charge for office space occupied. This company ascertained that the average will involved an outlay of a little less than $100.

# The Condition of Business

**Business as a Whole is Good Although There Are Some Signs of Recession. Automobile Production During First Quarter is Greatest on Record. Building Continues to Show Great Activity. General Price Level is Slightly Lower in April.**

BUSINESS is good. There is no doubt about that. The year of 1925 was a year of high prosperity, and 1926 has thus far continued at the high level set by its predecessor, if indeed it has not even been climbing to still higher levels. New first quarter high records have been made by steel production, car loadings, automobile output, bank clearings and building construction. Although complete figures for April are not available at time of writing, indications are that all of them, and many other indexes of business, continued to make similar high figures for that month.

This does not mean that there are no signs of recession. There are, but almost always there are, for it is not true that all business, in all parts of this country, go up and down together. Even in times of greatest general prosperity some kinds of business are in trouble and some flourish when depressions are at their worst. At this time, woolen mill activity and shoe production are low, silk consumption has been declining from recent high levels, and some curtailment is reported in cotton mill activity.

The fact that, in spite of a few weak items, business as a whole has been good during the first quarter of this year is evidenced by the following table prepared by the Federal Reserve Bank of New York.

(Computed trend of past years=100 per cent)

| | 1925 Mar. | 1926 Jan. | 1926 Feb. | 1926 Mar. |
|---|---|---|---|---|
| *Producers' Goods* | | | | |
| Pig iron *r* | 119*r* | 112*r* | 108*r* | 114*r* |
| Steel ingots | 107 | 110 | 112 | 112 |
| Bituminous coal | 83 | 113 | 114 | 101*p* |
| Copper, U. S. mines | 107 | 103 | 108*r* | 106 |
| Tin deliveries | 111 | 129 | 100 | 103 |
| Zinc | 96 | 105 | 106 | 98 |
| Petroleum | 117 | 114 | 113 | ... |
| Gas and fuel oil | 110 | 107 | 104 | ... |
| Cotton consumption | 96 | 93 | 102 | 103 |
| Woolen mill activity* | 93 | 86 | 84 | 85*p* |
| Cement | 129 | 123 | 108 | 116*p* |
| Lumber | 112 | 104 | 110 | 109*p* |
| Leather, sole | 82 | 64 | 69 | 69 |
| Silk consumption* | 137 | 132 | 121 | 111 |
| *Consumers' Goods* | | | | |
| Cattle slaughtered | 110 | 104 | 106 | 116 |
| Calves slaughtered | 116 | 116 | 116 | 109 |
| Sheep slaughtered | 107 | 103 | 114 | 127 |
| Hogs slaughtered | 88 | 82 | 76 | 93 |
| Sugar meltings, U. S. ports | 115 | 139 | 116 | ... |
| Wheat flour | 89 | 90 | 90 | 94 |
| Cigars | 96 | 86 | 94 | 110 |
| Cigarettes | 80 | 80 | 74 | 83 |
| Tobacco, manufactured | 98 | 111 | 109 | 111 |
| Gasoline | 129 | 137 | 136 | ... |
| Tires | 117 | 132 | 129 | ... |
| Newsprint | 113 | 119 | 127 | 130 |
| Paper, total | 102 | 94 | 100 | 100 |
| Boots and shoes | 95 | 84 | 91 | 92*p* |
| Anthracite coal | 85 | 2** | 30** | 104*p* |
| Automobile, all | 119 | 120 | 132 | 132 |
| Automobile, passenger | 121 | 120 | 133 | 137 |
| Automobile, truck | 112 | 121 | 128 | 110 |

*=Seasonal variation not allowed for **=Strike *p*=Preliminary *r*=Revised

The figures are in per cent of the computed normal production or consumption of the various lines of goods. Of the thirty-two items, only seven were below 100 per cent for March. For five of them the March figures are missing, but all five were well above 100 per cent for January and February.

## Construction

THE building industry continues to show phenomenal activity. This country came out of the war with a very considerable and generally recognized building shortage. After the depression of 1921 construction started in at a great pace to make up this shortage. Indeed the sudden revival of building was one of the most important factors in leading general business up out of that depression. New construction in 1922 broke all records and during each year since then it has broken the record of the previous year. This year, once more has started with every indication of being a record breaker. The following diagram prepared by the New York Federal Reserve Bank shows how uniformly and impressively construction has been growing since 1921.

## Automobile

MANY people used to be afraid that the craze for automobiles, if it continued, would interfere with the building of houses. They thought that the money which should go for the home was in danger of being spent for the auto. Furthermore, they said that the tendency was to mortgage the home in order to buy the auto. These fears were current in the days when automobile production was about one-tenth what it now is. It is an interesting commentary on these apprehensions that now, simultaneously, new building and automobile manufacturing are the two most outstanding instances of large industries that are exhibiting extraordinary sustained activity.

Automobile production has just seen the largest first quarter in its history and records for April, so far as at the present writing they are available, indicate a continuation of this activity. Men in the industry are predicting now a record breaking year for 1926. It is perhaps well to remark at this point, however, that 1924 began in much the same way with record breaking automobile production for the first quarter but ended with an annual total much below the preceding year.

## Iron and Steel

SO long as these two great industries, construction and automobile manufacturing, continue at a record breaking pace, many other businesses must likewise prosper. The iron and steel industry, for instance, supplies a great part of the materials for both buildings and cars, and, as would be expected, steel mills and blast furnaces are producing at high rates. A very interesting development in this connection is the fact that steel mills which specialize in automobile metal are complaining of a shortage of orders ahead. They are working at near capacity. There is no complaining on that score, but their orders are coming in day by day for relatively small lots and immediate delivery, so that they labor under the uneasy feeling that perhaps next month they may be shut down or running on half-time.

## Hand to Mouth Buying

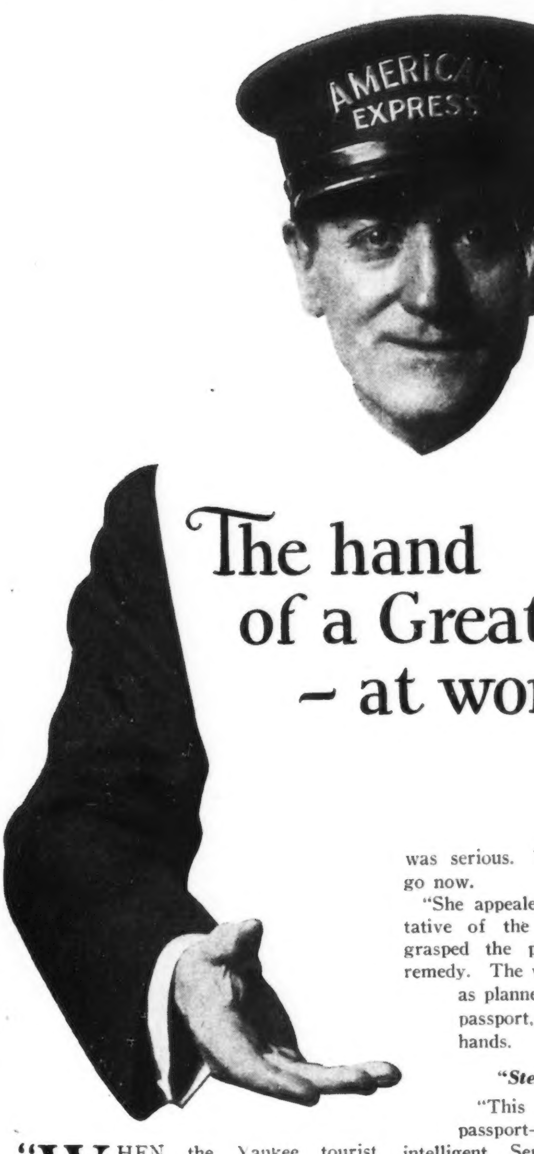
ONE might conclude from this state of things that the automobile makers are working with their ears to the ground, ready to slacken their activities at the first faint sound suggestive of a reduction in consumer demand. It would be unwise, however, to give too much weight to such a conclusion, because this condition is but an evidence of a symptom observed, and much complained of, during the past year or so, in many other lines of business. This symptom, or disorder, if it be such, is generally called "hand to mouth buying" and is observed not merely between the producer of raw materials and the manufacturer, but also between manufacturer and wholesaler, and between wholesaler and retailer.

This hand to mouth buying is probably with us to stay, at least for a good while, and should be reckoned with as a definite change in our business methods. The greater efficiency of our railroads, and in general our improved facilities for both communication and transportation, have helped to bring it about. A more important factor, however, is probably the fact that we are in a period of gradually falling prices. This means that any stock of materials or finished products is apt to be worth less money the longer it is held, and therefore it is the part of wisdom to keep such inventories at a minimum.

## Prices

WHOLESALE prices in March averaged 2.3 per cent lower than in February, according to the index of the Department of Labor. The New York Federal Reserve Bank's index of basic commodity prices, which is computed weekly, indicates a slightly lower level for April than for March. Prices of textile raw materials continued weak in April. Raw silk on April 28 was $1.25 or 18 per cent lower than at the beginning of the year. Spot cotton was 18.85 cents, compared with over

(*Continued on page 777*)



# The hand of a Great Service – at work :–

"WHEN the Yankee tourist finds Yankee travel service awaiting him in the far corners of Europe he is apt to become thoroughly sold on the foreign methods of the American Express Company. His frame of mind is the best possible tribute to an organization made familiar through constant contact.

***How It Helped an American Business Woman:—***

"Take, for example, the recent experience of an American business woman. The day before sailing from England for home she found that she must make a hurried trip to Paris. In her haste she forgot to have her passport viséd—and was stopped at Calais. The situation was serious. To Paris she must go—go now.

"She appealed to the Calais representative of the American Express. He grasped the problem and applied the remedy. The woman proceeded to Paris as planned, leaving her unendorsed passport, and her difficulties, in his hands.

***"Stepping on the Gas"***

"This is not a tale of a forged passport—just an expression of intelligent Service—a Service wholly within the law—and wholly American.

"Crossing the Channel by the afternoon boat, the agent hurried to London, presented the woman's passport at the office of the French Consul, got the necessary visé, returned to Calais by the night boat; and at nine o'clock the next morning the owner of the passport found the document ready and waiting for her at the Paris office of the American Express. At nine thirty-five she was a passenger on the boat train for Cherbourg, homeward bound, with her Paris business accomplished.

***"Did It Pay?"***

"Today she is one of our best and steadiest customers, in steamship bookings, travelers' cheques, hotel accommodations and other commodities. Did the effort pay dividends? Figure it out for yourself.

***Chambers of Commerce—Please Note***

"Then there was the case of a party of American business men, Chamber of Commerce representatives. None of their travel arrangements had been made through the American Express, although theirs was a class of business which the organization was particularly anxious to attract. At 1:30 P. M. one Saturday the tourists visited the Paris office of American Express with a problem concerning London hotel accommodations. They were leaving that afternoon and had just learned that London hotels were full. Could American Express help them?

***No "Magic"—Just Action***

"This was another case calling for quick action. The official conferred with members of his staff and found one who was willing to sacrifice his half-holiday in the interest of Yankee travel service. Introducing the volunteer to the Chamber of Commerce tourists, the official told them to proceed to London with full confidence that hotel accommodations would be provided. 'This man will meet you at the London station,' he told them, 'with your accommodation arrangements.'

"On the platform at Victoria station at 10:40 that evening they found the man to whom they had been introduced in Paris a few hours earlier. And with him hotel reservations for the entire group of travelers.

" 'But how did you do it?' they asked.

" 'Very simple, indeed,' he answered. 'Over by special airplane—out to our London manager's home—a few busy wires to the hotels—nothing simpler.'

***All in the Day's Work***

"To American Express officials the solution of such problems of travel as these is a part of the day's work. To these tourists it was an impressive display of Service. They talked of it to other Chamber of Commerce people when they returned to America, and spread the fame of Yankee travel service. It is a safe guess that the incident lost nothing through repetition.

"Did the incident pay? Ask a Paris official of the American Express Company and he will reward you with an appreciative smile and ask—'Does anything ever pay—better or more than—*Service?*' "

***Banks which sell American Express Travelers' Cheques assure their patrons American Express Service.***

*Extracts from an article in the March issue of Western Advertising by Malcolm MacDonald.*

# Kansas Guaranty Law Faces a Serious Crisis

By C. M. HARGER

**Supreme Court Decides That Banks Operating Under the Law May Withdraw by Forfeiting Bonds Deposited With State for the Faithful Payment of Assessments, and That After Such Forfeiture They May Not Be Again Assessed. Expected Effect of Ruling.**

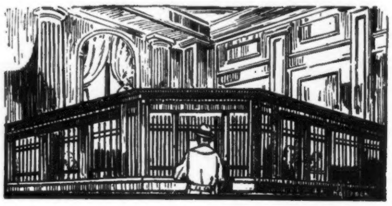
AFTER sixteen turbulent years, in which the legislature made numerous amendments, the Kansas bank guaranty law received its most serious blow when on April 10 the Supreme Court ruled that banks operating under the law may withdraw by forfeiting their bonds deposited with the state ($500 for each $100,000 of average deposits eligible to guaranty, less capital and surplus) for faithful payment of assessments and cannot be further assessed to liquidate the claims pending against the fund through the failure of other banks.

It is expected as one immediate effect of the decision that many banks will withdraw from the fund, eventually leaving less institutions to assess, consequently less funds from which to redeem the certificates issued to depositors of the failed banks beyond the bonds held by the state and whatever may be recovered from the assets of the suspended banks.

The Kansas guaranty law was the outgrowth of the progressive movement in politics. Adopted in 1909, it was made voluntary and about 700 banks joined the list of guaranteed banks. They were permitted to place signs reading, "Depositors are guaranteed by the depositors' Guaranty Fund of the State of Kansas" but mostly they condensed this to "Deposits Guaranteed." An assessment of one-twentieth of one per cent of the average guaranteed deposits less capital and surplus was provided, with four more assessments possible in one year if needed to maintain the fund at $500,000. Later the size of the fund was made $1,000,000, then reduced to the former figure. Certain deposits such as time certificates drawing interest were eliminated from the fund's protection.

Three failures occurred prior to 1920 and depositors were paid $83,050—in full. From that date until January, 1923, eighty-six banks of all kinds failed; since then there have been other failures. The bank commissioner has now in the hands of his insolvency department—a general receiver in control of all failed institutions—fifty estates. The state, in its brief in the case just decided, gives the condition of the guaranty fund August 20, 1925, as follows:

| | |
|---|---|
| Certificates issued to depositors....... | $10,417,319 |
| Certificates outstanding Aug 20, 1925.. | 5,484,052 |
| Contested certificates (later held valid). | 300,000 |
| Estimated value of failed banks' assets. | 2,236,000 |
| Estimated interest accrued on certificates .............................. | 685,506 |
| Par value of bonds deposited by banks. | 1,005,224 |
| Amount in guaranty fund............ | 17,996 |
| Deposits guaranteed June 2, 1925...... | 140,707,759 |
| Capital and surplus in guaranteed banks | 24,581,313 |
| Available annually by assessments..... | 350,000 |



THESE figures are stated to be approximately correct, though some records have not been perfect. The brief states that on March 5, 1926, there were about $4,500,000 of certificates in the hands of depositors of failed banks plus accrued interest at 6 per cent. Since then there have been other failures and court decisions adding to that amount while the assets' value is problematical. The attorneys representing eighteen banks which refused to pay assessments and declared their intention to withdraw from the fund, estimate the obligations at $7,085,000 and the value of the failed bank assets at $1,122,558, or a net obligation of $6,000,000. It is claimed that the utmost possible revenue from assessments is $341,445. With 630 banks on the fund list and with interest adding to the obligation (the legislature of 1925 abolished the interest on certificates but the banks claim the act unconstitutional) they declare it would take over 100 years to pay out; without interest and with no more failures it would require over twenty years.

At a meeting of the bankers in the fund, held April 19, the bank commissioner made his estimate of the situation to date. This gave gross liabilities of $6,748,202 and the probable value of the assets at $600,000. These assets with the cash on hand and the bonds up for deposit make a total estimated resource of $2,565,580 and leaves the guaranty fund "in the red", if settled up now, $4,182,622. The bankers in their meeting adopted after long discussion a resolution that they stand by the law until all claims are paid or the legislature "strengthens or repeals the law." If the law is repealed, the bonds will be automatically returned to the banks—but this was considered an unfair position for the bankers to take, according to the discussion at the meeting.

In 1925, responding to a strong message by Governor Ben S. Paulen who set forth the fund's perilous condition and urged some definite action in rescue, there was enacted an amendment abolishing the 6 per cent interest on depositors' certificates—a measure, however, of questioned constitutionality. So it has not been for lack of effort that the present situation has been reached.

### The Right to Withdraw

THE basic principle upon which the case in the Supreme Court was argued related to the right of a bank to withdraw from the guaranty fund, and the conditions under which it might do so, affecting the bonds on deposit with the state and the assessments thereafter to be levied. The state held that a bank could not be relieved until all claims against the fund at the time of withdrawal were liquidated and that the bonds were forfeited to pay these assessments so far as they would reach. The banks held that under the original law of 1909 withdrawal involved only paying assessments to date of withdrawal; posting, as required by law, a notice for six months, stating intention to withdraw; notifying the bank commissioner of such action, and then the bank had a right to the return of its bonds.

Back of this argument of the banks was the contention that the acceptance of the guaranty law by 700 banks was a contract made in 1909 and the state could not by legislation change that contract by later legislation through amendment to the law attempting to continue assessments to cover all claims due at time of withdrawal. The state held that the operation of the law was under broad police powers and that the intent of the law must be followed. The Supreme Court decision allows the banks to withdraw on six months' notice and sets the amount of the bonds deposited as their maximum liability.

Another decision given at the same time holds that deposits in banks which have sought to withdraw but where no public notice was given are still under the guaranty. In the specific case a bank which had been notified that it had been taken out of the guaranteed list but no public notice given, failed; the court held that the deposits were still guaranteed and that the condition of the bank did not disturb the depositors' rights and protection—such as it is.

### Still Has Advocates

DOUBTLESS some plans will be proposed for the rehabilitation of the guaranty system, for it yet has advocates. But many withdrawals are inevitable. Of the 1013 state banks of the state only 630

(*Continued on page 787*)

# A Few Simple Forms for a Real Estate Loan Department

By T. R. DURHAM

Vice-President, Chattanooga Savings Bank & Trust Company

**Considerable Volume of Business May Be Handled Without Requiring Many Forms. Application Blank Should Contain a Minimum of Questions, Detailed Information to be Covered in Examiner's Report. Close Scrutiny Over Taxes and Insurance.**

A CONSIDERABLE volume of business may be handled by a real estate loan department in the bank without requiring a large number of forms. No effort will be made to suggest a form for every phase of its operations because as a department grows more and more classifications are required, but in this article the necessary forms for use to properly handle the making and recording of loans will be reproduced.

The strictly legal forms, such as the note, or mortgage bond, the mortgage or deed of trust, or any other form of contract, will be not included because these must necessarily be prepared to meet the legal requirements of the several states.

## The Application Blank

THE first detail form used in connection with a real estate loan is the application blank.

Experience has shown that many applications are made which do not result in business. Therefore it is desirable to reduce this form to a minimum of questions and cover the detailed information in the examiner's report. There are many blanks of a much more formal nature than the following, but this will serve the purpose well enough:

**Blankville Savings Bank**

Amt. ........................ Time............
Applicant ........................................
Hus. or wife........................................
Residence ........................................
Business address ........................................
Lot No.......... Blk. No......... Add.........
........................................
Size of ground........................................
Imp.................. No.................. St.
Value of land.............. Bldg..................
Insurance ........................................
Option ........................................
Loan negotiated by..........................

Expenses:
- Commission or Atty's fee..........$........
- Abstract-guaranty ................ ........
- Registration ........................ ........
- State tax ........................ ........
- Appraisal and papers.............. ........
- Acknowledgement ................ ........
- U. S. revenue.................... ........
- Release ........................ ........

Total ........................$........

Other disbursements:..............................

THE back of the application blank can be utilized for a record of the disbursements of the proceeds of the loan, particularly when the loan is made to finish paying for a new building. The essential items entering into the construction are listed so that nothing of importance can be overlooked to make its appearance later in the form of a mechanics lien.

Following is a suggested form:

**Building Loan Disbursements**

Loan No...................... $............
Expenses of loan......................$........
Pay roll and miscellaneous.............. ........
........................................
Brick or stone work.................... ........
Electric wiring........................ ........
Electric fixtures ........................ ........
Excavating ........................ ........
Furnace ........................ ........
Hardware ........................ ........
Hardwood floors ........................ ........
Lumber and millwork.................... ........
Painting ........................ ........
Plaster, laths and cement................ ........
Plastering ........................ ........
Plumbing ........................ ........
Roofing ........................ ........

I hereby certify that the above list covers all claims for material and labor against the property secured by this loan. The house is completed and ready for occupancy.

........................................

AN examiner's form should be developed that will permit him to make a rather complete report by a small amount of writing and a few check marks. A report of this kind supplies the lending officer with a pen picture of the improvements so that he may acquire an adequate idea of the value of the property independent of the opinion of the examiner. After a photograph of the property is obtained, it may be attached to the report. Thus the files will contain a complete record of the condition and appearance of the property, which is valuable both for the finance committee and the investor, if the loan is subsequently offered for sale.

All of the data can be printed on a sheet 7 by 8 inches in size. On one side the following would appear:

**City Trust & Savings Bank**
**Blankville**
**Examiner's Report—City Property**

Application by..........of........for $........
On .........., 19.., I examined the below mentioned property, and report as follows:
Property is in name of........................
Occupied by................ as ..............
(Owner or tenant)
Legal description ........................
........................................
........Adjoining lots are held at from $........ to $........ per front foot. Size of ground offered as security is ........ feet front by ........ feet deep. Situated on........................
(Number of house and name of street)
Buildings are about ........... years old, are in .................. repair, are ..............
(Good, fair or bad) (Well or poorly) painted, and will stand $........ insurance.
Property would probably sell on reasonable terms for $.........
House on property offered as security is worth (average five year value).......$........
Garage ............................ ........
Other outbuildings .................... ........

Total value of buildings..............$........
Value of ground offered for this loan.... ........

Total value of buildings and ground...$........

On the reverse side, the following may be printed:

Briefly describe character of surrounding property ........................................
........................................
........................................
Is house modern or old style type?..............
Dimensions ........ by ........ feet.

| FOUNDATION | CONSTRUCTION |
|---|---|
| Brick .................. | Frame .................. |
| Stone .................. | Brick .................. |
| Concrete .................. | Stucco .................. |
| Brick piers .................. | Stone .................. |
| Wood posts .................. | Concrete blocks.......... |
| Underpinning .......... | |

| ROOMS | MISCELLANEOUS |
|---|---|
| Number 1st floor ....... | Basement .............. |
| Number 2nd floor ...... | Bath room .............. |
| Number medium ....... | Complete plumbing...... |
| Number large .......... | Kitchen sink only....... |
| Number small .......... | Sewer .................. |
| Number halls .......... | Cesspool .............. |
| Number porches ....... | City water .............. |
| | Well or cistern.......... |

| HEATED | LOT IS |
|---|---|
| Grates ................ | ........On grade |
| Hot air ................ | ........feet above grade |
| Hot water ............ | ........feet below grade |
| Steam ................ | ........level |
| | ........sloping |

| ROOF | INSIDE FINISH |
|---|---|
| Shingle ................ | Hardwood floors ........ |
| Composition shingle..... | Pine floors ............ |
| Roll roofing............ | Woodwork stained ...... |
| Slate .................. | Woodwork hardwood.... |
| Metal .................. | Plastered .............. |
| | Beaver board .......... |
| | Ceiled .............. |

| LIGHTED | MANTELS |
|---|---|
| Gas .................. | Brick .................. |
| Electricity .............. | Cabinet .............. |
| Neither .................. | Wood .................. |

| SIDEWALK | STREET |
|---|---|
| Concrete .............. | Asphalt .............. |
| Gravel .................. | Gravel .............. |
| Dirt .................. | Dirt .................. |

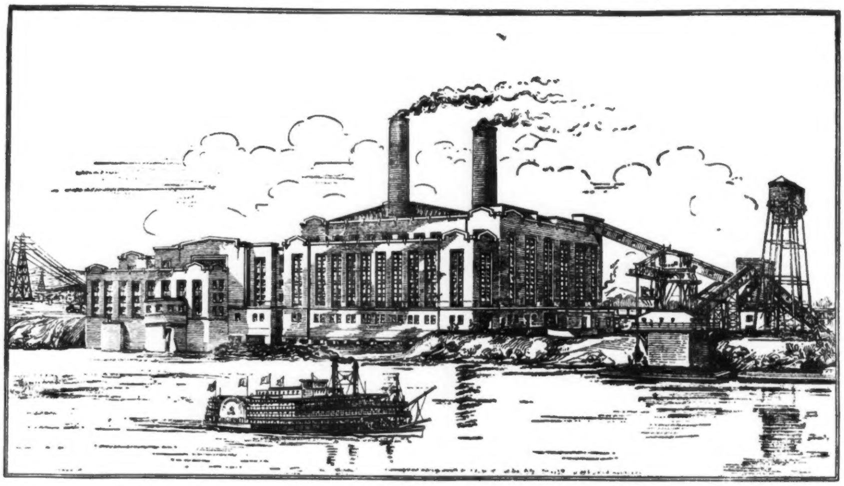
PHOTOGRAPH

After the loan is closed, the name of the borrower is indexed on a card, filed alphabetically, and the loan is registered on a card filed numerically. The full information could be carried on the following form:

Amount........... Month......... Day.......
Borrower ........................................
Wife—Husband ........................................
Address ........................................
Assumed by ........................................
Lender ........................................
Date.................. Maturity..............

(Continued on page 785)

## STORIES OF COLUMBIA SERVICE — No. II ELECTRIC DISTRIBUTION



*Columbia Power Station, Columbia Park (near Cincinnati), Ohio. Initial installed generating capacity 90,000 K.W. Dedicated to public service December 10, 1925.*

The area served with electricity directly by Columbia System extends from Piqua, Ohio, on the north, through the cities of Dayton, Middletown, Hamilton, Washington Court House and Cincinnati, Ohio, and includes Covington and Newport in Kentucky. These cities, together with the intermediate and surrounding territory, have a total population of close to a million.

The vigorous, consistent growth in electrical business of Columbia System during recent years is indicated by comparative annual statistics presented in the 1925 Annual Report.

| | *Electrical Revenues* | *System Peak Load (Kilowatts)* | *K.W.H. Generated and Purchased* | *Electrical Customers* |
|---|---|---|---|---|
| **1921**........ | **$2,969,163.54** | **75,000** | **281,984,073** | **77,514** |
| **1922**........ | **3,601,647.00** | **100,000** | **366,622,350** | **94,871** |
| **1923**........ | **4,648,832.50** | **112,000** | **443,433,188** | **126,366** |
| **1924**........ | **5,896,001.24** | **125,200** | **487,030,985** | **144,182** |
| **1925**........ | **7,430,287.45** | **199,000** | **734,625,184** | **236,497** |

This substantial development has resulted largely from the policy of Columbia System management which has injected highly organized sales methods into the commercial field of its public utility operations.

This is the second of a series of advertisements in which we propose to give you detailed information of the services performed by Columbia System companies for these communities, their industries and their homes. Investment in Columbia System securities is, in a real sense, investment in the marvelous Ohio Valley.

## COLUMBIA GAS & ELECTRIC COMPANY

OFFICE of the PRESIDENT

COLUMBIA SYSTEM

61 BROADWAY NEW YORK

## Condition of Business

(*Continued from page 770*)

21 cents early in January. Crude rubber prices have been falling off, and in the latter part of April were almost down to one half the prices prevailing at the beginning of the year.

The downward trend of prices is worldwide. The following tabulation shows the decreases from March 1925 to March 1926 in the United States and the principal European countries having stabilized currencies. The price index figures are recent prices in per cent of pre-war prices.

| | Price Index March 1925 | Price Index March 1926 | Per Cent Reduction |
|---|---|---|---|
| United States | 161 | 152 | 6 |
| England | 174 | 152 | 13 |
| Netherlands | 155 | 146 | 6 |
| Sweden | 168 | 149 | 11 |
| Germany | 134 | 118 | 12 |
| Switzerland | 170 | 151 | 11 |
| Austria | 143 | 119 | 17 |
| Hungary | 153* | 125* | 18 |

*February.

### *Stocks and Bonds*

AFTER a long bull market which lasted with occasional slight breaks about two and one-half years, stocks reached record high prices early this year and then established some new records for swift and drastic declines. In the latter part of April they made a substantial recovery and at the time of writing seem to be hesitating between an additional recovery and a resumption of the decline. Bond prices started on a long upward climb back in 1923, at about the same time as the beginning of the big bull market for stocks. Unlike the latter, however, bond prices have suffered no reaction and reached the end of April at a higher level than attained since 1917.

### *The Outlook*

THE break in stocks excited very general apprehensions that it would prove to be the forerunner of serious business depression. There is justification for this fear, because it is true that a bear market does usually accompany a depression in general business. The common idea, however, that the recession in business activity is to be expected close upon the break from the peak of stock prices is not in accordance with history. The big depression of 1921 started after the middle of 1920, and was hardly recognized as a serious matter until Autumn. Stocks had then been going down for just about one year. In other words, for the first three-quarters of a year after that bear market started, business activity was actually increasing. Again stocks broke for a short decline in the spring of 1923 and continued downward for some months while business remained prosperous, but the next year, 1924, experienced a degree of dullness quite comparable to this moderate stock price decline of 1923.

If we should rely implicitly on these precedents, and others like them, we would predict an important business depression starting near the end of 1926. History repeats itself, but never in precise detail, and if some of the conditions are different what happens may be quite unlike a repetition of the previous event. This time some important conditions are different. The most conspicuous of these is the continued high price of bonds above referred to, and the closely related fact of easy credit and low money rates. Usually bonds are already on their way down at the end of a bull market, and continue going down during most of the time while stocks are falling. The fact that they are behaving differently this time means more than that a minor element in our forecasting formula is misbehaving. It is not the fact that bond prices are staying up that is important, it is rather its correlative that money rates are staying down. Business depressions are usually preceded by a rise in interest rates, and a contraction of credit, and at present there seem to be no symptoms of such a condition arising.

Nevertheless, we feel safe in saying that no one yet knows enough about the causes of depressions to be justified in dogmatically setting a date for the end of the present wave of prosperity.



## Report on Aviation

GOVERNMENT inaction in the United States has resulted in civil aviation developing much more rapidly abroad than in this country except as to mail service, it is pointed out in a report of the Commerce and Marine Commission. No demand exists in the United States for government aid subsidies, it states, but it recommends the setting up of a Bureau of Civil Aeronautics in the Department of Commerce to provide for the legal status and control of civil aviation and to foster airway facilities as is now done for waterways.

One reason civil aviation has not developed here is because of the lack of government recognition and the enormous expenditure necessary by private individuals to organize the business in the absence of government established facilities.

# How to Handle Soldiers' Bonus Certificates

JAY MORRISON of the Washington Mutual Savings Bank, Seattle, has prepared the following set of instructions to bankers for handling Adjusted Compensation Certificates, better known as Soldiers' Bonus Certificates:

### What the Bank May Do

1. Any bank may make the loan if the bank is empowered to lend upon obligations for which the faith and credit of the United States is pledged.
2. The bank may loan without the consent of the beneficiary of the certificate.
3. The bank may sell the note to another bank, transferring the certificate with it.
4. The bank may discount the note with the Federal Reserve Bank, even if the bank offering the note is not a member of the Federal Reserve System, provided, the note has a maturity not exceeding nine months.

### What the Bank Must Do

1. In case it sells the note, the bank must promptly notify the veteran by mail at his last known post office address. In practice this means by registered mail.
2. The bank must be sure that the borrower is the soldier named in the certificate as its original recipient from the government.
3. In case it sells the note or presents it to the director of the Veterans' Bureau for payment, the bank must accompany it with an affidavit made by an officer of the bank and acknowledged before a notary public that the bank has not charged or collected, or attempted to charge or collect, any fee or compensation except interest as provided in the note, in respect of the loan.
4. The bureau will furnish blanks for such affidavits.

### What the Bank Must Not Do

1. It must not loan in excess of the loan value of the certificate at the time of the loan.
2. It must not charge a rate of interest more than 2 per cent above the rate charged, at the date of the loan, for the discount of ninety-day commercial paper by the Federal Reserve Bank in the district where the bank is located. (At this date, February, 1926, the maximum rate would be 6 per cent.)
3. It must not sell the note to anyone but a bank or trust company.
4. The penalty for charging any fee or a rate of interest in excess of that allowed above is $100, to be recovered in a civil suit brought by the veteran.
5. Any negotiation of a certificate, or assignment of it or loan made on a certificate in violation of any of the above is void so that in case of violation the bank may lose the amount loaned, the interest thereon, and the penalty of $100, together with costs in the civil action, if brought.

### General Information Regarding Loans

1. In case the note is rediscounted by the Federal Reserve Bank, the rate of interest charged by the Federal Reserve Bank shall be that charged by it on ninety-day notes drawn for commercial purposes.
2. The amount of the loan value of the certificate plus interest compounded annually at 6 per cent to its maturity never equals the matured value of the certificate.
3. If the veteran does not pay the note at its maturity, the bank may, at its option, after six months after the loan is made, present the note and certificate to the director of the Veterans' Bureau, Washington, D. C. He then may, at his discretion, pay the note with interest in full. But he does not have to do so.
4. If the veteran does not pay the note before the maturity of the certificate and the director of the Veterans' Bureau has not paid it at the request of the bank prior to the maturity of the certificate, the director shall at the maturity of the certificate pay to the bank the amount of the unpaid principal and unpaid interest, at the rate fixed in the note.

Bear in mind that this maturity may not occur for over seventeen years and that unless stated in the note that interest is to be compounded annually, only simple interest can be collected. Therefore, ALL NOTES TO BE USED IN CONNECTION WITH THESE LOANS SHOULD PROVIDE FOR INTEREST COMPOUNDED ANNUALLY IN CASE OF DELINQUENCY OF PAYMENT.

5. The death of the veteran effects the immediate maturity of the certificate and note.
6. The certificate and the proceeds of a loan on it are exempt from all attachments, taxes, levies by creditors or any other legal process.

# New Banking

(*Continued from page 765*)

fiduciary to his own order and deposited to his personal credit (thousands of such checks being so drawn and deposited every day and the transaction being perfectly legitimate in the great majority of instances) led your committee to feel there is great need for its enactment in every state as a protective measure, for banks are daily taking risks of liability in connection with transactions of the character described. A decision just rendered by the United States Circuit Court of Appeals emphasizes this danger.

"This committee in cooperation with the State Legislative Council in each state has been urging the passage of this Act. Progress, however, has not been in keeping with its importance as, in four years, it has been passed in only nine states, as follows: Colorado, Idaho, Louisiana, Nevada, New Mexico, North Carolina, Pennsylvania, Utah and Wisconsin. California and Oregon also have statutes which protect the bank as provided by the Act.

"In view of the fact that over forty state legislatures meet in 1927 and that a large number of state bankers associations will shortly hold their annual conventions, it would seem that the consideration of this Act with a view to urging its passage as a protective measure at the next sessions of the respective legislatures in states which have not already passed the Act, is a matter of prime importance for consideration at the bankers' conventions."

# Developing Trust Business From the Inside

DEVELOPING trust business from the inside is now generally regarded as an effective means of developing business on the outside. For there is no more effective argument that a trust officer can use in selling a bank's services than to be able to say that the officers and directors of the institution themselves have intrusted the execution of their will and the management of their estate to it.

On the other hand, the disclosure that an officer or director of a trust company has died without having made a will or that he has not evidenced his faith in its management by naming it to act as executor or trustee is a weighty handicap for the new business man to overcome. Such a misfortune is sometimes the deed that spurs the trust officer on to insure against the repetition of such a calamity.

## *He Left No Will*

IN a large eastern city, the vice-president of a successful trust company died. For twenty-five years he had been preaching the doctrine that every man should make out his will and should name a corporate fiduciary to see that its provisions were carried out. With his passing, it was found that he had left no will. The shock was great—for if there was a man in his city who might have been expected to have a will tucked away in a safety deposit box, it was he. When representatives of the trust company approached outsiders, they generally met with the rebuff: "I don't know why I should make a will. Your own vice-president died and he knew more about your company than I do but he did not make a will."

It was this blow that started a canvass among the other forty officers and led to the discovery that more than a fourth of them were without a will. A campaign was pushed to sign up all of the officers and was successful. It was extended to the heads of departments and then to the directors. All except three of the directors were brought into line. On the desk of every officer and department head, there appeared a simple little card, which stated, "I have drawn my will and have named the——— Trust Company as Executor and I recommend you to do likewise."

The force of personal example has been found sufficiently strong to bring a great deal of new business to a trust company. Today banks in many sections of the country display, on the desks of their officers, these little cards. They have been found to be not only an effective advertisement but a suggestion that frequently leads to securing wills from customers, who are calling at the bank on other business.

## *They Saw the Point*

VARIOUS ways have been devised to bring directors into line. In a western city, the trust officer succeeded in obtaining the designation of the bank as executor of the wills of only three directors. To emphasize this shortcoming, he sent a letter to each director requesting his attendance at a special meeting. As soon as the directors were assembled, the trust officer told them that he wanted to talk over the discontinuance of the trust department. This came as a great shock to the directors, who professed surprise that the effort should be abandoned after such a material outlay had been made to get it under way. This gave the trust officer an opportunity to state that the solicitation of wills from people around town was proving a failure because those approached were continually asking if certain directors had made their wills and had agreed to intrust their estate to the bank's management. The directors saw the point—and signed up.

The inauguration of a spring drive was the occasion that a large trust company in one of the principal cities took for sending out a card to all stockholders, asking them to agree to take a part in its conduct. A card reading, "I have made due provision for the care of my estate, by will or trust, and named the..........Trust Company as executor," was inclosed to each who had taken this action. The card was displayed so that it would attract the eye of the casual visitor. The drive, it may be stated, resulted in $11,000,000 of business, including $1,500,000 in wills and trusts.

One of the officers of this institution, having a large desk with a glass top, put a card at each corner. A customer came in on an entirely different matter. He shifted his chair when he saw the first card, probably due to the fact that he had received letters relative to making his will. He glanced at the second card and then said: "Aren't you sort of rubbing it in?" "That is the intention," the trust officer replied. He got the will.

## *Alternate Executors*

BANKS that are desirous of getting wills from all of their officers and directors are sometimes stumped because these men are found on the directorates of other institutions.

To get around this difficulty, some of the trust companies have persuaded them to name the bank as an alternate executor or trustee. In this way, it is possible to show that the officers and directors, who designated other institutions, have faith in the bank, as well.

Procrastination is the reason frequently assigned for the inability of a trust company to get all of the directors in line. In the case of two busy directors, a small eastern institution succeeding in having them put a codicil on their wills in which the institution was named as executor and thus covered the directors 100 per cent.

## Human Side

(*Continued from page* 740)

profane in speech and utterly regardless of the value of a dollar and a cent, and, because he was unkempt of person, and because he was harsh of language, and because of some of his personal habits, he had no following, no clientele, among the wealthy and the well-to-do and the socially elect of the little town where he lived. The drunkard in the gutter, the ne'er-do-well, the down-and-outer, the never-waser and the use-to-be-er—those were his patients, and because most of them had not the wherewithal to pay him for his services in their behalf, they visited upon him only the gratitude of their thankful hearts; but they knew, as their more prosperous citizens did not, that the rheumatic, knotted, twisted old hands were quick to soothe—quick to find and soothe human misery.

Inside of that rumpled and often soiled shirt front beat a heart that was quick and pregnant with human sympathy and, as he grew older, by reason perhaps of his habits, and, certainly, by reason of his carelessness on the money side of his professional duties, he grew poorer in this world's goods rather than richer. When the day came when he no longer could pay the rent on the modest little suite he had occupied in one of the tiny office buildings the town afforded, he was compelled, in this emergency, to fit himself up a sort of combination living quarters and office in two rooms with bare walls on the second floor above a little, small, dirty livery stable; and there, all alone, he did his meager, awkward housekeeping, and there he saw his usually penniless patients.

And since now he felt he could not afford the money to hire the local sign painter to suitably mark his new place of business, he made for himself his own sign post on an unplaned rough bit of pine planking and lettered on it in crude sprawling capitals this legend, "Dr. Thomas Riley, his office is now upstairs."

### *Dr. Thomas Riley Passes*

THAT board he nailed to the twisted hitching post which stood in front of the stable. And one day he was missing from his accustomed haunts and, when he had been missing so long that suspicion was aroused and search was made for him, the search led up to the wretched little door on the second floor, and when they broke the door open, they found him there, and the tousled old head was at rest now on the rumpled pillow, and the twisted, knotted old hands were folded on the pulseless breast.

Two nights before, driving twenty miles up in the hills, in bitter weather, to bring a measure of relief to some poor, stricken penniless soul, he had caught pneumonia, and all alone he had made his way back to the cheerless hole which he called home, and there, all alone, he had fought his last grim fight against that enemy with whom, on behalf of others, he had contended, so often, and so valiantly and so successfully, and he had lost that last fight.

To his funeral there came none of the wealthy and none of the socially prominent, and none of the chosen elect of the town, because they had known him, most of them,

## Human Side

(*Continued from page* 781)

only as a shabby, bent old figure, seen sometimes on mean back streets; no carriages followed him to the cemetery; those who came to bear testimony to the love which they bore him and to the debt of gratitude which they owed him, walked afoot, since it was the only mode of locomotion they had. But hundreds of them—the poor, the wicked—so-called wicked—paupers from the county poor house, to the number of hundreds, marched afoot behind the shabby hearse, to the little cemetery on the outskirts, and as they walked some of them plucked frost-bitten and withered weeds and grasses and wild flowers that grew by the roadside, and those were the only floral offerings that covered the mound of sod when the clergyman had done his service and when the sexton with his spade had done his, and gone away. And still afoot, the mourners, and the most sincere mourners they must have been that one can fancy, trudged again the long bleak three miles back to town.

And when they had returned, that sorry little procession, a few of the more thoughtful of them resolved themselves into a sort of volunteer emergency committee on ways and means. They believed that a man, who had done so much to alleviate human misery for so little return in the goods of this world, deserved some sort of honor, some sort of monument to mark the place where he would sleep until the judgment day. But when they took in the finances of the situation, it seemed that even this small ambition might not be realized, for the old man had driven so many years in his rickety old side-bar buggy that it had been sold for just enough to pay the cost of shovelling him under ground, and the only suit of decent black he owned and the thin, tarnished watch he had carried so long, both had been buried in the same grave with him.

Then they went to his room and looked about to see what sums of reliable money might be owing to him for services rendered, and there they found that, probably in his last conscious hour, he had drawn in that old shabby ledger, opposite each name of a debtor, with, perhaps, his last intelligible thought, and surely, with his last bit of rational strength—he had written with fingers already cramped in the chill of death, opposite each name, the words "Paid in full."

But, in this emergency, the village drunkard, who was present, and sober for once in his life, had an inspiration, and voiced it, and those who were with him agreed that his inspiration was right. So, in a body, they marched to the door of the livery stable and they took from where it stood the old hitching post with its sign and carried it on their shoulders, as a loving burden, sacredly; and there, among the frozen clods, they stood it at the head of the grave where their friend and benefactor slept.

And there for years it stood until the suns of summer bleached out the words and until the rains and snows and sleets and winds of winter washed the paint away, that old sign board stood reading, quite truly, I think, "Dr. Thomas Riley, his office is now upstairs."

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Provide the officers and employees of your bank with their own copies of the AMERICAN BANKERS ASSOCIATION JOURNAL —sent to their homes where they have time to read and reflect.

## The Meaning

(*Continued from page* 741)

Florida, even the crop of tourists are going to become more valuable and will contribute their part to the drama of the South's development. There may be some romance in the making but it will represent a part of the total.

In a current number of a well known magazine under the caption of "America Discovers Dixie," a southern writer and publisher presents an interesting picture of what may happen to the South during the next half century. It intrigues your imagination as nothing else among the published statements and makes you long to live to see the day when such things may be completed. One's curiosity is excited by such terms of the new "land of opportunity" and as the "one place left for pioneering on a vast scale." Cold facts are used to support the contention. The growth of the per capita wealth is recorded as an evidence of what may be expected and comparisons are made with other sections based upon statistics taken from sources of reliability. When it is realized that up until 1890 no southern state, except Florida, had regained its pre-war position in the matter of material wealth in the hands of the people, one can appreciate the progress of the last thirty-five years and accept that growth as a convincing basis of our future prosperity.

We understand, of course, that we must bear our part of whatever economic ills to which the world may be heir, or of whatever problems may characterize our domestic affairs, but we are relatively in as good a condition as any other part of this country when it comes to meeting our obligations of whatever kind. During the last few years we have acquired a sort of financial independence of which we had never dreamed before, for sometimes we form and carry through some large transactions in which the capital has been furnished largely or altogether from southern sources. In the old days all such financing was done away from home, and of course much of it is yet, but we are gradually expanding the volume of northern securities among southern holders, which in a way helps to square the account and aids in supporting our claim of being less dependent.

### *The Old Soubriquet*

FOR a long time after the close of the Civil War we not infrequently received and perhaps deserved the soubriquet, the "poor old South." That is true no longer, and if our present prospect for an uninterrupted development of our natural resources continues to materialize, we will take our place along with the Middle West with its greater fertility, the Far West with its boundless enthusiasm, as an important part of a great nation. The writer to whom I referred quoted Bion Butler who had summed up the South's advantage as amounting to a "conspiracy of nature." This means that it is not altogether a matter of natural resources. These together with the true character of the population of any territory constitute its real wealth. We have here the essential qualities for the adequate compound. We are proud of the unmixed qualities of a true citizenship handed down from the pioneer stock of early American history, and with such a background of purity of breeding and the culture from our improved schools growing in power and influence as we spend more for the education of our youth, we will learn how to contribute toward the graces of life for the benefit of all of America. The bankers must look to the soundness of the economics of this new Eldorado, and, if successful, it means a due regard for the rights of others, a proper respect for the use of money, but a true appreciation as well for the fundamental qualities which make up the world's store of human happiness and especially the sum of human contentment.

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Read the warnings in the Protective Section of the Journal. They may save loss and annoyance.

# Comparing British and American Discount Rates

AMERICAN and British rediscount rates are not strictly comparable due to the difference in the basis on which the loan of bank credit is made in the two countries. Benjamin Strong, Governor of the Federal Reserve Bank of New York, told the House of Representatives' Committee on Banking and Currency that there was a widespread misapprehension as to the nature of the discount rates that prevailed in the two centers.

"The discount rate of the Federal Reserve Bank of New York, using that as an example, is sometimes criticized for being below the market rate for money," he said. "Today (April 8) our discount rate on commercial paper is 4 per cent and the governing rate among commercial paper brokers is from 4¼ to 4½ per cent. The suggestion is made that the proper rate for the Federal Reserve Bank would be somewhat above the rate at which commercial paper sells. That grows out of the knowledge we have of the Bank of England's rate, I believe, but the facts in the two markets differ materially.

"There is no commercial paper in England, as such. The loans made by big commercial banks of England to their customers are not made by taking a note from the customer, as a rule, but by an over-draft arrangement, which does not produce a negotiable instrument at all, and the rates charged by them for the over-draft arrangement are fixed somewhat above the rate of the Bank of England, and when the Bank of England advances a discount rate, generally the rates charged by the joint stock banks to their customers on their account also advance. So the corresponding type of loan made to commercial borrowers by British banks is generally above the rate made by the Bank of England, just as our commercial rate is somewhat above our Federal Reserve rate.

"THE difference is that our business produces commercial paper eligible to be bought at the bank. The Bank of England established a rate for which they will discount such bills as are being purchased by the Reserve Banks in the open market under the authority of Section 14 of the Federal Reserve Act.

"The proper way would be to compare our discount rate for bills with what is known as the minimum rate in England. The rate at which we discount paper and make loans to our banks is somewhat higher than the discount rate for what they call Lombard loans or collateral loans made by the Bank of England to their customers, secured by various types of collateral. In the course of evolution of the Federal Reserve System, as our money market develops and changes its character somewhat under the influence of the Federal Reserve System, it may be that the real discount rate will be the rate that applies simply to bills and the rates at which we make loans to our member banks will correspond, in the course of time, to the so-called Lombard rates where they make loans to their customers secured by collateral which is usually about 1 per cent above the discount rate.

"The reasons for the difference are various. The commission charged by a bank for accepting a bill of exchange will run, on the average, at a rate of about one-quarter of one per cent for a ninety-day bill. That is one per cent per annum. So the cost of credit to a borrower, who is financing a commercial transaction by a bill of exchange instead of a note in hand, is partly made up of the commission, which is at the rate of one per cent per annum, and that is the value of the bank obligation on the face of that paper and corresponds to the indorsement which we get on commercial paper when it is brought to us for discount at the Reserve Bank.

"THERE is possibly a reasonable allowance which should be made for the very narrow shave that is made by dealers in turning the bills over, of say an eight or a sixteenth of one per cent. But the difference between that rate at which commercial paper sells in the market, 4½ per cent, and acceptances, 3½ per cent, fundamentally represents the value of the acceptance of the bank on the face of the draft, which does not appear on the face of commercial paper, and that is the compensation that the bank gets for lending its credit to the customer."

## Few Simple

(*Continued from page* 774)

Interest rate........ Payable........ and.......
Option ........................................
Insurance $........... Commission $...........
Description of property.........................
Street No. .....................................
D. T. Recorded Book.... Vol.... Page.... Date....
Loan sold to...................................
Abstract guaranty..............................
Loan paid .....................................

On the back of the card register, provision is made for a record of interest payments which may be used, or if preferred, the regulation tickler record will suffice.

If the loan is payable in monthly payments, the back of the cards may be adapted for use as a record for the number and date of each payment.

One method of handling monthly payment loans is to use the installment note instead of making a separate note for each payment. On the back of the note have printed the figures in columns for the purpose of entering the credits. In this way the total amount paid on a note may be determined by multiplying the number of payments instead of adding the long list. A pass book similarly numbered serves as a receipt for the borrower. As will be seen from the following leaf from the passbook, the borrower has all of the information before him and can at any time during the life of the loan determine just how much he has paid and the balance due without checking up a bunch of receipts.

**City Savings Bank and Trust Company**

Record of Payments Made by

...............................................
on a note for $........
Dated ...................... payable in installments of $.......... per month.
Loan No...........

| Date | Principal | Received by |
|---|---|---|
| ............1 | ............... | ............... |
| ............2 | ............... | ............... |
| ............3 | ............... | ............... |
| ............4 | ............... | ............... |
| ............5 | ............... | ............... |
| ............6 | ............... | ............... |
| ............7 | ............... | ............... |
| ............8 | ............... | ............... |
| ............9 | ............... | ............... |

Whether a bank keeps them for its own investment or sells real estate loans to its investors, it is most important that it continue to exercise a very close scrutiny of taxes and insurance.

To keep up with tax payments, a simple form may be used. On this, taxes on the land and improvements should be noted with the receipted bills from the state, county and city.

Taxes should be checked by the official records annually and all delinquents required to pay up under the requirement which should be included in all mortgages.

The insurance cards are filed according to the date of expiration and, if the borrower does not supply a renewal, the bank should immediately take out insurance, the premium on which should, under the terms of the mortgage, become a charge against the property. Some banks have the provision covering these items go so far as to result in the immediate maturity of the loan if either item becomes delinquent whether or not the bank has advanced the funds to pay them.



A form for keeping up with insurance payments is:

| Policy No. | Ins. Co. | Agent | Owner | Property | Mtgee. | Loan No. | Amt. | Remarks |
|---|---|---|---|---|---|---|---|---|
| ........ | ........ | ........ | ................ | ............ | ........ | ........ | ........ | ........... |
| ........ | ........ | ........ | ................ | ............ | ........ | ........ | ........ | ........... |

A separate file is usually required for abstracts, but for all other title papers, insurance policies, examiner's reports, correspondence, etc., in connection with a loan, a heavy manila envelope, size 4¾ by 10½ inches, made to fit a standard document file, is an excellent receptacle. The essential papers for each loan are listed on the outside and until such papers are received, the envelope may be kept in a temporary or incomplete file. When completed it is then placed in the regular file in numerical order. In this connection, it is well to use a numbering machine for the purpose of stamping every item used in the record of a given loan. Subsequently, if any paper, document or record become separated from the file the number indicates its proper place without referring to the index.

On the face of the envelope, the following legend should appear:

No.............. ..........Amount, $..........
Applicant ..................................
Wife or husband.............................
Address ....................................
Lender .....................................

| | Assumed by |
|---|---|
| Dated........................ | ............ |
| Due.......................... | ............ |
| Interest due........&.......... | ............ |
| Insurance $.................. | ............ |
| Option ...................... | ............ |
| Rate ............%.......... | ............ |
| Commission $................. | ............ |

PAPERS FILED

| | |
|---|---|
| Application............ | Guaranty } Abstract } ............ |
| Principal bond......... | |
| Policy ................ | First mortgage......... |
| Contract .............. | Tenant's disclaimer.... |
| Examiner's report...... | M. L. bond............ |
| | Recorder's certificate.... |

MEMORANDA

Loan sold to.................................
.............................................
.............................................

In the November 1925 issue of this magazine, there appeared an article telling how to proceed in providing for the sale of the real estate mortgage loans to the investing public.

## Convention Calendar

| Date | State Association | Place |
|---|---|---|
| May 13-15 | New Jersey | Atlantic City |
| May 17-19 | Georgia | Columbus |
| May 18-19 | Missouri | Excelsior Springs |
| May 20-21 | Kansas | Wichita |
| May 20-22 | Alabama | Montgomery |
| May 25-27 | Texas | Galveston |
| May 26-28 | Pennsylvania | Atlantic City, N. J. |
| May 26-29 | California | Del Monte |
| June 4-5 | Oregon | Gearhart-by-the-Sea |
| June 7-9 | Wisconsin | Wausau |
| June 8-10 | Washington | Walla Walla |
| June 9-11 | Ohio | Cleveland |
| June 9-11 | Minnesota | Minneapolis |
| June 11-12 | Utah | Richfield |
| June 14-15 | Idaho | Pocatello |
| June 14-18 | Michigan | S.S. "Noronic" |
| June 15-16 | South Dakota | Watertown |
| June 16-18 | South Carolina | Spartanburg |
| June 17-18 | Illinois | Springfield |
| June 17-19 | Virginia | Roanoke |
| June 17-20 | District of Columbia | Hot Springs, Va. |
| June 18-19 | Connecticut | New London |
| June 19 | Maine | South Poland |
| June 21-23 | Iowa | Sioux City |
| June 21-23 | New York | Quebec, Canada |
| June 22 | North Dakota | Grand Forks |
| June 23-24 | West Virginia | Huntington |
| June 25-26 | Colorado | Glenwood Springs |
| July | Wyoming | Sheridan |
| July 15-17 | Montana | Butte |
| Sept. | Kentucky | |
| Sept. 2 | Delaware | Rehoboth |
| Sept. 21-22 | Indiana | Lafayette |
| Oct. 22-23 | New Mexico | Roswell |
| Nov. | Arizona | Nogales |

| | | |
|---|---|---|
| June 18-19 | New England Bankers | New London, Conn. |
| July 13-16 | American Institute of Banking Convention | Dallas, Tex. |
| Sept. 20-23 | Financial Advertisers' Convention | Detroit, Mich. |
| Oct. 4-7 | A. B. A. Convention | Los Angeles, Cal. |

## Kansas Guaranty

*(Continued from page 772)*

are in the list and by May 1st 53 had served notice of intention to withdraw. With the assets of the failed banks, the $1,000,000 in bonds deposited by the banks and forfeited and whatever fund is on hand, over $4,100,000 in depositors' certificates will have to be paid. Roughly it will be one-fourth as expensive for the guaranteed banks to forfeit their bonds as to submit to further assessments. Any attempt to increase the assessments materially would cause hardship on many institutions. Proposals to have the state assume the deficit would hardly make headway as there is a feeling that the guaranty system was on the whole a somewhat dubious policy, whatever may have been its value in steadying public confidence in time of stress. That it led to reckless banking is held by many bankers who saw institutions managed on expansive plans that could have no basis in sound finance receive liberal deposits because they were "guaranteed."

Another problem which yet may have to be settled by the supreme court is the priority of claims of the $4,182,000 in certificates held in the state. Some are in the hands of original owners; others have been passed around or have been deposited for collateral for loans in banks. If these are paid pro rata, about 50 per cent of their value will be realized. But if the certificates are paid in the order of issuance one-half of the holders will get nothing. This opens a fine legal question on which the statutes are silent, their only reference being that when the guaranty fund is not sufficient to meet claims against it depositors shall be paid pro rata and the remainder raised from future assessments against the guaranteed banks. If no more assessments can be made, the court might hold that only the pro rata shall be paid.

### *Public Funds Without Bonds*

THAT the legislature next winter will repeal the guaranty law seems now probable though it may seek to reestablish it in some improved form. In Oklahoma where a similar law was repealed two years ago no provision was made to remunerate the holders of some $8,000,000 of certificates, though in that state the membership in the guaranty list was compulsory. The Kansas statutes have even provided that guaranteed banks may hold public funds without giving bond as is required from national banks and state banks not guaranteed. As a result of this law a large amount of public funds is tied up in the claims against failed banks which because guaranteed gave no bond for protection. Withdrawal from the fund will necessitate that many banks now public depositaries give bonds for protection of such deposits.

This financial crisis of the guaranty fund is what has been prophesied by many leading bankers of the state since its inception. They admitted that as a fair weather law it might work but that a period of stress would engulf it in overwhelming debts, as has been done. The frozen loans of the past five years brought heavy burdens and failures resulted as anticipated. Whether or not it universally helped to obtain and to hold business is also an open question. In the average town are banks both guaranteed and not guaranteed; both have their normal amounts of deposits, frequently the non-guaranteed bank having the lead. Some banks that have posted notices that they would withdraw from the fund report that it has made no noticeable difference in their



## Official Notice

¶STATEMENT OF THE OWNERSHIP, MANAGEMENT, CIRCULATION, ETC., REQUIRED BY THE ACT OF CONGRESS OF AUGUST 24, 1912, of the AMERICAN BANKERS ASSOCIATION JOURNAL, published monthly at New York, N. Y., for April 1, 1926.

¶State of New York, County of New York, ss. Before me, a Notary Public in and for the State and county aforesaid, personally appeared James E. Clark, who, having been duly sworn according to law, deposes and says that he is the editor of the AMERICAN BANKERS ASSOCIATION JOURNAL and that the following is, to the best of his knowledge and belief, a true statement of the ownership, management (and if a daily paper, the circulation), etc., of the aforesaid publication for the date shown in the above caption, required by the Act of August 24, 1912, embodied in section 411, Postal Laws and Regulations, printed on the reverse of this form, to wit:

¶1. That the names and addresses of the publisher, editor, managing editor, and business managers are: Publisher, F. N. Shepherd, 110 East 42nd Street, New York, N. Y.; editor, James E. Clark, 110 East 42nd Street, New York, N. Y.; managing editor, none; business manager, James E. Clark, 110 East 42nd Street, New York, N. Y.

¶2. That the owner is: (If owned by a corporation, its name and address must be stated and also immediately thereunder the names and addresses of stockholders owning or holding one per cent or more of total amount of stock. If not owned by a corporation, the names and addresses of the individual owners must be given. If owned by a firm, company, or other unincorporated concern, its name and address, as well as those of each individual member, must be given): The American Bankers Association, 110 East 42nd Street, New York, N. Y. (A voluntary, unincorporated association of banks: Oscar Wells, First National Bank, Birmingham, Ala., president, and Fred N. Shepherd, 110 East 42nd Street, New York, N. Y., executive manager.)

¶3. That the known bondholders, mortgagees, and other security holders owning or holding 1 per cent or more of total amount of bonds, mortgages, or other securities are: None.

¶4. That the two paragraphs next above, giving the names of the owners, stockholders, and security holders, if any, contain not only the list of stockholders and security holders as they appear upon the books of the company but also, in cases where the stockholder or security holder appears upon the books of the company as trustee or in any other fiduciary relation, the name of the person or corporation for whom such trustee is acting, is given; also that the said two paragraphs contain statements embracing affiant's full knowledge and belief as to the circumstances and conditions under which stockholders and security holders who do not appear upon the books of the company as trustees, hold stock and securities in a capacity other than that of a bona fide owner; and this affiant has no reason to believe that any other person, association, or corporation has any interest direct or indirect in the said stock, bonds, or other securities than as so stated by him.

¶5. That the average number of copies of each issue of this publication sold or distributed, through the mails or otherwise, to paid subscribers during the six months preceding the date shown above is..——
(This information is required from daily publications only.)

JAMES E. CLARK
Editor

¶Sworn to and subscribed before me this 15th day of March, 1926.
¶(My commission expires March 30, 1927.) [SEAL] Lucille P. Gropp, Notary Public.

deposits. The public which in the beginning perhaps was somewhat interested long ago lost that interest. If any banks were aided, it was those of small capital and resources and in rural communities where the assurance of "guaranty" perhaps held deposits—may be in the end proving a liability rather than an asset when came a time of depression. Certainly it did not prevent failures, though it is claimed it did lessen runs, for about the same proportion of state banks that were guaranteed failed as of those that were outside the list.

It will require six months before the withdrawals now going in can become effective. Those taking this action do so because they prefer to lose their deposit of bonds, averaging large and small about $1,600, to being responsible for five times that amount in assessments—provided none withdrew—and greater as the number of guaranteed institutions decreases.

Kansas is admittedly over-banked. Counting state and national, it has 1270 banks, an average of a bank to every 1400 persons or to every 350 families. They are not quite so numerous as filling stations but run the drug stores a close race. A mushroom growth in the days of high prosperity in war times added hundreds of needless institutions, making the havoc of the deflation period the more disastrous. Failure has disposed of about one hundred; consolidation is going on moderately; eventually the state may get back to a normal relation of its banking power to the demands of the state.

The elimination of the guaranty feature should have a helpful effect on the business. For years it has been a bone of contention, the guaranteed bankers charging unfriendliness on the nationals and those outside the fund. It has resulted in two banking associations, one for all the bankers and one for those having guaranteed banks. These will now doubtless coalesce, making a more united front in the promotion of the financial interests of the state and eliminating the natural rivalries frequently appearing in the varied ambitions of the members heretofore. Altogether it is salutary that the air has finally been cleared and the exact status of the guaranty fund established.

## One of the Best Ways to Build Business

"THIS department is very firm in its belief that one of the best ways to build stronger and better banks in Iowa is to have greater interest taken by the directors in their banks. In making an analysis of the banks which have closed in this state we find, almost without exception, that they were banks in which the directors did not direct, and knew very little, if anything, of what was going on until the bank got into serious trouble. Officers of banks owe it to themselves to divide the responsibility by insisting that the directors give proper attention to their bank."

The foregoing is quoted from a circular letter to the state banks of Iowa by L. A. Andrew, superintendent of the Department of Banking of Iowa, to the state banks under his jurisdiction, but that part of it concerning the best way to build stronger and better banks applies with equal force to banks everywhere.

The department last September ordered that meetings of directors in all banks under its jurisdiction be held once a month, and that reports of the meetings be forwarded to the department within five days after the meeting. As an aid to the directors the department furnished a tentative program for these monthly meetings, which is as follows:

"Reading of oath of directors.

"Report by the active officers on the business of the bank during the past month to include the main items of expense; comparison of earnings and expenses with the previous year; a résumé of earnings and expenses since January 1; and a statement of the general condition of the bank for comparison with last year.

"Loan committee and officers to report to the directors the condition of the loans, particularly the excess loans, if any, for all of which they are directly responsible; also in regard to bills payable, rediscounts, loans which may become other real estate, etc.

"Discussion of the real estate items, possibilities of disposing of the same and their proper handling.

"Interest rate paid on deposits.

"Have one of the directors give a talk on what he advises for increasing the business

of the bank, and in what way the directors can be of the most service to the bank.

"Officers and loan committee should present any loans they have under contemplation, particularly those of any size, and have them considered in advance."

## Basis of Wages

"DESPITE definite experience to the contrary, there is still a tendency, even in certain quarters usually well informed, to believe that capital can be manufactured by the banks," says Barclay's Bank Review, "but a little investigation soon reveals the incorrectness of this view, and it would seem that that the misunderstanding arises through the failure to distinguish between capital and credit. Speaking broadly, capital, in its economic sense, consists of real things, such as factories, plant and machinery, raw materials, etc., while credit provides the means for obtaining possession of them. The credits placed by banks at the disposal of their customers represent a transfer—or under inflation, a creation—of the power to compete for existing goods or services. No doubt it might be possible, by credit inflation, to stimulate temporary activity, but in such circumstances, production proceeds, not in response to actual orders, based upon a genuine increase in purchasing power, but with a view to obtaining the profit arising from constant price advances. Production on these lines, however, is bound to become considerably unbalanced, and in any case, inflation has to be repeated and intensified to maintain activity, even for a comparatively short period—a course which, as so many European countries have experienced, ultimately ends in disaster. Most of the inflationary countries are now endeavoring to restore sound methods of finance, and to do so are borrowing substantial sums abroad, at interest, in order to obtain control of the real capital they require before they can restore economic health. This fact in itself is evidence that real capital cannot be increased by inflationary methods, but only by saving, *i.e.*, by securing a surplus of production over consumption.

"In this connection, the proposed conference in London of the Ministers of Labor of Great Britain, Belgium, France, Germany and Italy to consider the possibility of securing an effective international agreement for regulating hours of labor is important, for the decisions reached may have an appreciable influence upon future production and consumption and, therefore, upon the rate at which capital can be accumulated. No doubt, an international agreement of this kind has much to commend it. In some cases, a reduction in working hours might increase efficiency and expand production; but in others, it would no doubt result in a lower output per individual. It is therefore necessary to recognize that measures of this kind usually involve a choice of advantages and disadvantages. On the one hand, there is the possible benefit of shorter hours, while, on the other, is the fact that no body of people can, for a long period, consume more than they produce. A high standard of production is essential for a commensurate standard of living, and anything which adversely affects the one must, in the long run, react adversely on the other. Just as an increase in real capital depends upon a surplus of production over consumption, so an increase in real wages depends upon increased productiveness. Inflation is just as powerless to raise real wages as it is to promote a healthy trade activity, for the real value of wages depends not upon the number of currency tokens received, but upon the quantity of goods they command. If the volume of credit is increased without a corresponding increase in real things, then the value of credit in terms of commodities is correspondingly reduced. Similarly, if wages generally increase, without a corresponding increase in production, or if they are maintained while production is reduced, then a reduction in the purchasing power of wages will follow. The desirability of gradually improving the general standard of living will be universally admitted, but it is not always sufficiently realized that one of the essential means to this end is to increase the available supplies of productive capital—a result which can only be secured by saving. It is essential, therefore, that any reductions in working hours should be accompanied by measures designed to insure greater efficiency and a larger output per hour worked."

*A glimpse of Argentine's Wall Street. This narrow street is in the heart of Buenos Aires' financial district*



## Cost of Taxable Securities

THE government, through its adherence to the policy of issuing taxable securities, is now paying $112,500,000 annually in interest to collect about $3,000,000 in taxes.

Roughly $15,000,000,000 out of the $20,000,000,000 public debt is taxable, the other securities are tax-free. On the taxable issues the government is paying approximately ¾ per cent more interest than on the securities that are exempt from all taxes, normal and surtax rates.

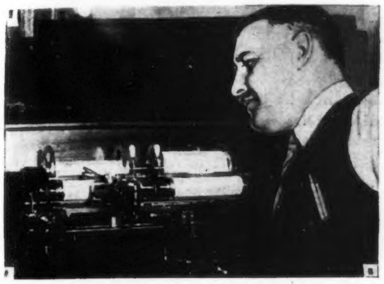
When the Liberty and Victory loans were brought out, the interest earned on government securities was subject to the surtax rates, which ran as high as 60 per cent. Now, however, the surtax rate is only 20 per cent.

In 1923, the total interest reported by individuals in their income taxes as having been received from U. S. securities was $43,941,000. Much more than half of this interest was reported by individuals having incomes of less than $25,000 and almost half—$18,000,000—was received by persons having income of less than $10,000, who paid no tax whatever on this portion represented by income from Federal securities (the income from this source being free from normal tax and subject only to the surtax rate). In other words, the tax received by the government in taxing the income from its own securities did not exceed $3,000,000.

Most of the tax free securities outstanding are held by corporations—which are not subject to surtax rates. Less than one-sixth of the tax-free securities outstanding are held by those who make income tax returns. This indicates that there were relatively few who poured their fortunes into tax-exempt bonds to keep from paying any income tax, despite the widespread publicity that the wealthy were dodging taxes by purchasing tax-free securities.

When the government issued bonds, it had to pay one per cent more for money when the income from the bonds was taxable. For instance, when the Victory loan was floated, the government offered two kinds of bonds—one bearing a rate of 3¾ per cent, which was tax-free; and the other bearing a rate of 4¾ per cent, which was taxable. As may be observed, the government paid 1 per cent more interest for the privilege of issuing taxable bonds.

The government gave the right to the holders of the 3½ per cent tax-exempt First Liberties to exchange them for taxable bonds, paying 4¼ per cent interest. The average rate of interest on the taxable securities outstanding is about ¾ per cent higher than on the portion which is wholly tax-exempt. Thus the Treasury is paying out more than $100,000,000 annually in excess of the amount that it would have to if the whole debt were tax-free.



*Machine that now transmits checks overseas*

## Farm Surplus

*(Continued from page 757)*

old for $100 per acre. In this latter case, he had increased his capital account by 150 per cent. It is easy to see what this did to his net percentage of income, contrasted with his original position. If he had been able to make 6 per cent on his original investment without any allowance whatever for the increased cost of operations, which of course did take place, he cut his net income, based upon his capitalization, about one-half when he had completed his expansion program. But, worse than that happened. His calculations had been made upon a price for his product which reflected a wartime demand and buying power of government money which, when the war was over, was suddenly curtailed, and with demand gone, with buying power withdrawn, he found his gross selling price again cut in two. If his gross, therefore, at the high figure, had enabled him to make 3 per cent net on his new capitalization, this now was cut, at least, one-half by the reduction of his gross selling price, and instead of making 6 per cent return, as he was able to do perhaps on his original $100 acre farm, he had since found himself lucky if he has made 1½ per cent on his new capital account.

This general statement of the situation may be successfully attacked, but if the sober truth were admitted, I am confident that something of this kind underlies 75 per cent of the present difficulty.

How can it be remedied? I believe that time and intelligent hard work is the surest restorative of better conditions. I am perfectly certain that no magic of a Houdini, or legerdemain of trick legislation, can accomplish the result. There are a few facts, however, which it seems to me must be faced and accepted before a start to better things can be made. Perhaps the first and most important one is a recognition of what has always seemed to me to be obvious: that farming, as such, never was, is not now, and I do not believe will ever be, a, so called, money-making proposition. By this, I mean a business in which a man may engage with the certainty of being able, over a period of years, from the production and sale of farm commodities, to accumulate great wealth.

I know there are those who will say that unless farming can be made a successful money-making proposition, there is no hope for the future of the country. My argument with such people will turn on the correct definition of what is a satisfactory money-making business. I believe that if farming is intelligently and industriously followed, it is a satisfactory business, but I do not believe that it is sufficiently a money-making proposition to attract those who are ambitious to play for big fortunes.

I know there are those, also, who say that many men have grown rich in the past in agriculture. I do not think they have from the mere production and sale of farm commodities. The men who have grown rich in the past from agriculture have owed their success most largely to the ownership of what would now be considered very cheap lands, which over a period of years, have shown quadruple and more appreciation in values, and this is true not only of those actively engaged in farming, but of those who have operated our large cattle ranches.

But if agriculture does not mean great wealth, and it certainly does not involve a life of idleness, ease, or luxury, it does mean much more. It means, if intelligently and industriously followed, and always it must be intelligent and industrious, a character of independence vouchsafed to no other trade or profession.

How do I know this? I know it by experience, and I know it by observation. If I may be pardoned a personal reference, I think I can prove my case by my own twenty years on a farm. My father owned a hill farm in the mountains of Kentucky, which for character of soil and productivity, was perhaps as uninviting as exists almost anywhere in this country. He had a family of seven children. I do not believe his cash income averaged $300 per annum, and yet he managed to give us, in ample supply, the necessities of our station and condition, and such comforts as were common to the community. We did not have the so called

luxuries of today, neither did our neighbors, and we did not miss them; but we had then, as I know the farmers of today have, more good, wholesome food than any man working today on a salary of $2,500 per year can buy for his family and be able to pay his grocery bill, without paying any other of his debts.

These conditions have not changed, and the farmers of today, who are complaining of their inability to make money enough to pay for their necessities of life, are enjoying at home, as a natural heritage of their business, comforts and luxuries which the man in the industrial centers, working for a salary, is spending every dollar of his income to obtain, and then is not getting anything commensurate with those enjoyed by the farmer.

It is these so called unledgered items of the farmer's income that are too often lost sight of in the calculations made by our reformer friends, who would legislate a living wage and universal prosperity to those engaged in agriculture. If the farmer, as a whole, would be happy again, he must take stock of his blessings and thank God for them, get rid of his quack doctors of political bunkem, revalue his plant and equipment, and start over again in full knowledge of the fact that he must face keen and effective competition, that he must work hard and intelligently, that he must calculate in his income inherent and undeniable items, which are not measured in dollars and cents. When he does this, I feel perfectly certain that over a period of years, taking the good and the bad as it comes to all classes of business, he will find that he has lived well, that he has had a fair margin for the enjoyment of all the necessities of life, and a surplus for those luxuries which he has a right to claim, and above all, that he will have had a chance to be an independent individual, a real man, and a self-respecting citizen.

## Produce Business

(*Continued from page 766*)

that stabilization in the industry was practically unknown until government and state agencies directed attention to it about a decade ago.

Since 1915 the Department of Agriculture has developed at least four lines of nation-wide work for this industry that have tended to stabilize it to such an extent that it is a common saying that the industry has been revolutionized during this decade. These lines of work have now become an inherent part of the marketing machinery of the country for its huge supply of fresh foods.

### *Bankers See Benefit*

THE help that these lines of work have given to the many bankers who aid in financing the huge combined crops of fruits and vegetables, often beginning with the growing stage, extending through harvesting and storage, and through the active marketing periods, can scarcely be estimated. Standardization, market news, and shipping point and market inspection work have been welcomed and appreciated by bankers from the beginning as basic to their success in this financing and now one of the first letters that comes to the Department in appreciation of this new plan, outside those direct from the industry itself, is from an Arkansas banker, who with his brother banker in his small town has insisted that his clients this year raise in quantity other crops than cotton.

Together these bankers have arranged for the growing of several hundred acres of tomatoes, green beans and cucumbers among their farmer patrons, and they realize their responsibility in marketing these new crops to advantage. They are quick to see in this announced plan the protection these growers, inexperienced in the perishable trade, will have in dealing with distant and unknown dealers if they can connect with firms who have subscribed to follow established trading rules in cooperation with the government.

Realizing the advantage to their clients and to themselves of the use of standard grades, bankers in many parts of the country aided in extending their use by directing to them the attention of growers and shippers whom they were financing, for the basis that standardization provides for fixing loan values accurately is second in importance only to the effect it has on stabilizing markets. Realizing the benefits of having their clients know market conditions and prices before shipping, bankers have often taken a leading part in securing a market news service for their territories and in giving wide publicity to governmental market reports. Realizing the benefits in reducing the number of rejections of shipments of their

clients, bankers in many instances took an active part in securing for their territories the shipping point and market inspection services developed by the Department in cooperation with the states. Now such bankers can aid their clients in a comparable way by explaining the new plan of registration and recommending its use.

### *Standardization and Loans*

THE present popularity among bankers of short-time loans to the Northwestern apple shippers, where previously there was hesitation and reluctance, is due to the successful standardization of the crop. Even individual growers can now secure about 50 per cent of the selling value of their apples. Properly financed, the crop is distributed over a long season which makes possible a steady supply to consumers at reasonable prices in place of alternate gluts and bare markets which are disastrous to the industry and in the long run more expensive to the public. Similar illustrations could be given all along the lines showing the benefits to every class of people that the industry touches, and in one way or another it touches all.

In furthering these lines of work by recommendation, explanation and publicity, the banker is not only helping the grower, shipper, buyer and dealer to improve market conditions in a business formerly filled with speculation and sudden and heavy losses, but he is building up within his own territory additional and safer collateral.

## The Paper Market

(*Continued from page* 756)

the increase in the size of banks to extend greater credit, and (3) the increased use of the open market. Between 1880 and 1890 we find the brokerage house established as far West as Chicago, Milwaukee, Kansas City, St. Louis, St. Paul and Minneapolis. Over $30,000,000 of paper was sold by one western house previous to 1887 before a single default occurred.

In the fourth quarter of the last century, the brokers themselves, without solicitors or salesmen, bought and sold their paper calling on bank to bank with the notes in their pocketbook or hat ready for immediate delivery. An interesting picture of one of these early New York brokers was given a few years ago by a well known dealer in an address before the Kentucky Bankers Association:

"Dressed in a very tall silk hat and frock coat of the period, he would each business morning stop in to see some merchant friend. The call usually ended in the consignment for sale of a small batch of bills receivable. The broker put the original paper inside the hat band of his 'topper.' Then he proceeded to the Chemical, the Importers, or one of the other few New York banks, doffed his hat with great ceremony took out of that inner hat band the paper, and bargained at some length with the venerable banker as to whether the rate should be 10 per cent or 12 per cent. No balance sheets, no credit departments—merchants' paper was judged according to the maker's character and standing in the business community."

Another picture, one of an early Chicago broker given by himself a short time ago, is equally as interesting, indicating the directness of the early dealings between banks and brokers and also the gradual change from double name to single name paper:

"Generally the entire stock of paper was in my pocketbook and if the office sold a note, a boy had to run out and find me so that the note would not be sold over again. We prided ourselves on the fact that if we took an order delivery would be certain and prompt. In order that you may realize what pioneer promptness meant, I will illustrate it: I walked in one day on Mr. D. R. Forgan—after a critical examination and discussion of the stock in trade in my portfolio, he selected several notes and then asked me when he might expect delivery. I picked up a scrap of paper lying on his desk, figured the discount and said: 'Give me your check—the delivery is made'."

By 1890 eastern banks had become some-

what acquainted with the western names and their credit standing. New York and Boston banks began buying paper from western brokers. This channel for the flow of funds was largely followed by the appearance of eastern brokers in the western fields seeking new accounts.

THE development of the note brokerage business to modern proportion with branches in the principal cities of the country, branch managers and salesmen in many cases equipped with automobiles to call weekly on country banks, has come about largely since 1907 when the highly liquid character of this form of investment became so generally recognized.

The intersectional activity of paper, that is, the distribution of the notes of a single concern to banks across the continent, is one of the more recent developments of the open market. Henry Clews sold the receivables of New York concerns to New York banks; later New York dealers, Boston and Philadelphia dealers handled the notes of concerns located largely in their own city and made sales largely to local banks.

With the increase in the banking strength of the West and South, brokers opened offices in the principal cities of the country, Detroit, St. Louis, Minneapolis, Seattle, Portland and San Francisco or made arrangements with correspondent brokers in distant cities. Today the notes of a St. Louis cotton merchant might be sold to five hundred banks located in every city of the Union.

The following table compiled from daily records over the past four years gives a complete segregation of borrowers by basic lines of industry:

| | 1922 | 1923 | 1924 | 1925 |
|---|---|---|---|---|
| Building material | 18 | 16 | 26 | 31 |
| Drugs and chemicals | 109 | 102 | 115 | 122 |
| Finance companies | 9 | 32 | 55 | 74 |
| Foodstuffs | 516 | 405 | 563 | 585 |
| Leather and shoes | 182 | 171 | 148 | 144 |
| Lumber and furniture | 148 | 148 | 243 | 245 |
| Metals and hardware | 411 | 357 | 456 | 462 |
| Paper and woodpulp | 40 | 38 | 58 | 57 |
| Rubber goods | 20 | 9 | 11 | 15 |
| Textiles and dry goods | 734 | 732 | 882 | 851 |
| Tobacco products | 22 | 26 | 28 | 30 |
| Miscellaneous | 50 | 135 | 120 | 138 |
| Total | 2259 | 2171 | 2705 | 2754 |

The growth in the open market during recent years has not been a steady growth. It is quite probable that the number of concerns which obtained credit in the open market in the high credit-pressure year of 1920 was considerably greater than the number which was active in 1922 and 1923 and probably approximated 2705, the number of active borrowers in 1924.

In 1920, immediately following the inflation, interest rates were high but credit was vitally needed by the great majority of concerns to carry larger inventories and slow accounts. Borrowers were forced to seek credit wherever it was available. The number of active borrowers in the open market expanded again in 1924 and 1925 as more business men came to realize the distinct advantages in securing part of their credit from outside banking institutions.

The open market borrowers were divided into Federal Reserve Districts during 1925 as follows:

| | |
|---|---|
| Federal Reserve District No. 1 | 325 |
| Federal Reserve District No. 2 | 408 |
| Federal Reserve District No. 3 | 173 |
| Federal Reserve District No. 4 | 135 |
| Federal Reserve District No. 5 | 223 |
| Federal Reserve District No. 6 | 246 |
| Federal Reserve District No. 7 | 492 |
| Federal Reserve District No. 8 | 174 |
| Federal Reserve District No. 9 | 89 |
| Federal Reserve District No. 10 | 163 |
| Federal Reserve District No. 11 | 150 |
| Federal Reserve District No. 12 | 176 |
| | 2754 |

During the past fifteen years temporary industrial financing through note brokers in the open market of this country has become an extremely important phase of our modern banking system.

Ignoring entirely the actual detailed advantages derived by both the purchasing bank and the industrial seller of paper participating in this method of financing—the great intangible benefit to both factors is the broadening of understanding and intelligence created by the contact.

Banks in every section of the country offer their criticism and comment on every name selling paper—they in turn, are advised of the opinion of all other bankers.

The paper market is the greatest single coordinator of credit thought and research—it is the common meeting ground of the large city bank and the small country bank—it is the link between the leading industrial concerns and the entire banking system of the United States.

## Pacific Coast Trust Conference

IMMEDIATELY preceding the annual convention of the American Bankers Association at Los Angeles, October 4-7, there will be held in the same city the fourth regional trust company conference of the Pacific Coast and Rocky Mountain states. The conference date is September 30 to October 2. The conference territory comprises the states of Arizona, California, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington and Wyoming, making up the twelfth Federal Reserve district. The meeting which will be under the auspices of the Trust Company Division of the American Bankers Association will be open to representatives of trust companies and state and national banks authorized to do fiduciary business.

The following committees composed of bankers of Los Angeles or vicinity have been appointed to have charge of various details of the meeting: Hotels and arrangements, J. D. Carson, vice president and trust officer, Pacific-Southwest Trust and Savings Bank, Chairman; E. B. Pentz, Security Trust & Savings Bank; Marc Ryan, Bank of Italy; Don Cameron, Union Bank & Trust Company; J. H. Griffin, Security Trust & Savings Bank; W. D. Lacey, First Trust & Savings Bank, Pasadena. Finance, John Veenhuyzen, vice president and trust officer, Security Trust & Savings Bank, chairman; W. W. Powell, Title Insurance & Trust Company; B. H. Grigsby, Pacific-Southwest Trust & Savings Bank; J. S. McKnight, Marine Trust & Savings Bank, Long Beach; C. J. Hall, Pacific-Southwest Trust & Savings Bank, Pasadena. Program and publicity, A. L. Lathrop, trust officer, Union Bank & Trust Company, Chairman; B. L. Smith, California Trust Company; J. F. Keogh, Title Guarantee & Trust Company; H. B. Thomas, Citizens Trust & Savings Bank; H. H. Ashley, Hellman Bank. Reception and entertainment, C. Sumner James, vice president, Citizens Trust & Savings Bank, Chairman.

The business meetings will begin at two o'clock, Thursday, September 30 and end at noon Saturday, October 2 and will be followed by a banquet that evening. The conference was timed with the American Bankers Association convention in order to enable delegates to combine attendance at both meetings while in Los Angeles. Chairman Lathrop of the program committee has announced that suggestions from trust officials for topics to be discussed at the meeting will be welcomed.

## German Banks

(*Continued from page* 760)

connections, large parcels of bank shares have been sold to foreign financiers. The first bank to pursue this policy, the Deutsche, sold 40,000,000 marks of its stock to America. Between December 1925 and February 1926, seven banks, some like the Disconto and Dresdner, of first rank, followed the Deutsche's example. This is sound policy. The holding of considerable parcels of German bank stock by financially strong foreign groups tends to maintain quotations in times of bourse depression, and that is vitally necessary because if an European bank's stock falls below par the confidence of its customers is always shaken. No leading German Bank stock has been quoted below par since the first gold mark balance sheets appeared. Since the lowest quotations were reached, in most cases in November 1925, the shares of the four "D" banks have risen over 30 per cent. Deutsche Bank shares have risen from 102½ to nearly 137, Disconto from 100¼ to 136¾, Darmstaedter from 102 to 138, and Dresdner from 100 to 119¾. This movement indicates public confidence, for the dividend yield at such prices is rather low for a country where fully secured 10 per cent gold mortgage bonds have only lately risen above par. The remaining three-quarters of 1926 are likely to witness a further revival of confidence. And owing to the increase in bourse activity and to the hardly less remarkable revival of the home capital market, the banks' profits ought this year to exceed those of 1925. In addition to other good omens the last weeks have witnessed the first signs of a manufacturing recovery. Unemployment has begun to decrease. As exports have of late increased very considerably, and as trade relations are being reestablished by means of commercial treaties with the few countries with which treaties were not concluded in 1925, the export boom will probably develop.

## Banks Give Too Much Free Service

(*Continued from page 764*)

banks are so afraid that they will lose a patron, or so fearful that they will not get one in competition with some other bank that they are ready to grant credit when even reasonably good banking would dictate that the loan should not be made, that the account should not be taken on, or that the account should be forced out of the bank. The public is not served, therefore, in any true sense or in any final end by encouraging or permitting the excessive cut-throat competition that has gone on in banking, for in banking just as in any other kind of business, when competition goes beyond certain bounds, it leads to poor business conduct, inefficient business organization and final loss to the public. Sooner or later, as in other lines of business, sanity must assert itself and the dictates of reason will prevail with the result that many present day services now rendered by banks will be eliminated as unessential and injurious to the banking business. We will then realize that there are too many banks and that centralization of greater banking power will not mean monopoly of credit but that it will mean that credit will be granted in a safer manner.

## The Power

(*Continued from page 746*)

the position of running the Federal Reserve System. What are you going to do today that will have an influence upon the future?" The answer is always the same: 'Well, you are the practical fellows who are running this: you have got to decide that.' And that is the difficulty. Our examination of the past produces the most accurate knowledge of past action and reaction, but when it comes to a decision as to what we are going to do for the future, then just human judgment has got to govern. There is no mathematical formula for the administration of the Federal Reserve System or the regulation of prices."

### *Governor Norris' Views*

GOVERNOR NORRIS of the Federal Reserve Bank of Philadelphia told the committee that if stabilization were limited to cutting off the extreme peaks in the fluctuation of prices, this could be done and had been done during the past three years. He stated, however, that if Congress should confer authority by law to do this, it also conferred responsibility and, if conditions were such as to make stabilization impossible, it would invite blame of the Federal Reserve System. No small part of the stable price level of the past few years may be attributed to the judgment shown by the business community in refusing to permit itself to get into an extended condition.

Paul M. Warburg, former Governor of the Federal Reserve Board, laid his views before the committee. "No banking system, to my mind at least, can undertake to provide a stability of prices,' he stated, "and I believe it would be dangerous to place the Federal Reserve System in a position where the responsibility for extreme fluctuations in price levels could be laid at its door. Naturally those in charge of the Federal Reserve System should always watch most carefully fluctuations in the price level and fashion the policy of the System, as far as it is practicable, so as to combat excesses of inflation or deflation; but the powers of the central banking system in this regard are distinctly limited. Interest rates may be a contributing factor in affecting price levels, but to my mind, they are only one of many factors of all the world-wide economic forces at play, which in the end determine price levels."

### *What Economists Think*

THE economists were found to be in general agreement with the practical bankers as to the limited powers of the Reserve System to control prices but there were some among them who favored the formal inclusion of the declaration that the Federal Reserve Board should be directed to use all of its powers to promote stable prices.

Professor Irving Fisher of Yale described inflation and deflation as "twin evils." "To try to cure the results of one by adopting the other is like running over a man with an automobile and then trying to cure him by backing up and running over him again," he observed, in maintaining that stabilization is the only remedy. Dr. Fisher said that the Federal Reserve directors had power,

within certain limits, to achieve this end but admitted that they could not do so if gold became too abundant or too scarce. Possessing the present large gold reserves, the Reserve System can keep the general level more or less stable for probably five, ten or twenty years, he told the committee. The Federal Reserve authorities, he found, have been wisely stabilizing the price level through alterations in the rediscount rate, purchasing and selling securities in the open market, circulating gold certificates in lieu of Federal Reserve notes and exercising moral suasion over the banks. Dr. Fisher said that he favored the adoption of the proposed legislation because it declared a national policy that would be binding upon the members of the Federal Reserve Board in its future operations.

The point that the mere control of the gross volume of money in circulation is not of itself a strong enough power to bring about stability in the price level was scored by Dr. W. T. Foster, director of the Pollak Foundation of Economic Research, who stressed the fact that the Reserve banks could not dictate how the money was to be used. While he asserted that there would be an advantage in having an avowed policy, Dr. Foster said "it would be unfortunate for business in general and for the future of the Federal Reserve System if the idea became widespread that because such a bill as this was passed, therefore the Board actually did have the power, under all conditions, to bring about stability in the price level. The Board," he admitted, "actually has used its power for helping to stabilize the price level as, in 1923, its open market operations, and its changes in rediscount rates actually did help to curb the inflationary movement and help to bring about a period of relative stability of the price level." The real difficulty in keeping prices on an even keel comes from the fact that our financial system is largely a system of financing production rather than a system of financing consumption, he insisted.

### The Farmer's Interest

PERHAPS the dominant reason for the bill being brought before Congress is the belief in some quarters that the farmer would be particularly helped by stabilization as the national policy of the Federal Reserve System. The farmer is sure to get caught in a period of deflation, it is argued, because during inflation the prices of land invariably go up and the enterprising farmer is apt to buy land in larger quantities than any one else and, when prices go down, to find himself with property that it is almost impossible to pay for. Farm products seem to drop further and quicker and to go back more slowly than other commodities because the farmer can not shut off his production like the industrial producer, who can shut down his plant at will.

Professor James Harvey Rogers of the University of Missouri expressed the opinion that the bill was "a very sound and very effective form of farm relief" for the reason that there would no longer be the incentive to speculate on the prices rising.

Management and not arbitrary rules must be relied upon to prevent wide fluctuations in the prices of commodities, according to Professor O. M. W. Sprague, of Harvard

University, who boldly asserted that central banks—and in the case of the United States, the New York Federal Reserve Bank—did exercise control over fluctuations in the general price level. There is no automatic formula for attaining this end, he said, and the question as to the power and degree of control exercised by the banks over the general price level has not yet been fully tested.

Dealing with a practical situation, Professor Sprague drew attention to the recent drop of about seven points in the Department of Labor's general level of commodity prices and asked: "What steps should be taken? Should the Federal Reserve banks buy securities and thus increase the volume of credit? With what results? Some prices would rise, but not all. Which ones no one knows. They would not necessarily be the prices of agricultural commodities."

The statement that the general price level is an increasing factor in determining central bank policy and the prediction that it would be of even more importance in future years was made by Dr. Sprague. If prices had not been considered by the management of the Federal Reserve System, he stated that he would favor a law compelling it to consider the general price level.

Perhaps the most concise statement of what powers the Reserve banks had was furnished by W. F. Hickernell, of New York University.

"Gold prices are influenced but not actually determined by the Federal Reserve banks," he stated in a memorandum prepared for Dr. Jeremiah Jenks. "The Federal Reserve banks can prevent extreme fluctuations but cannot prevent the index number from drifting to a more or less permanent level, up or down. Excess gold can cause a general rise which the Federal Reserve Board cannot prevent. New inventions and improved methods of production can lower prices of individual commodities and cause the index number to recede, theoretically. Declines in prices, due to inventions, etc., benefit mankind and are desirable. However, it is desirable to prevent extreme fluctuations and the Federal Reserve Board can do a great deal in this direction. It can 'promote stability.' It can not entirely checkmate the inflating influence of excess gold production on the one hand or the deflating influence of complete resumption of the gold standard in Europe, expansion in world output of goods, etc. Thus while the Federal Reserve banks can measurably check extreme fluctuations, we should not raise false hopes that they can maintain an index number at a fixed level."

## Foreign Bonds

(*Continued from page* 761)

connection it must be remembered that taxation power varies with income not in arithmetical but in geometric proportion. That is to say, if the national income of a people has increased 20 per cent over a period of years, the taxation power of the government is expanded not by a like 20 per cent but by 40 per cent.

### *Simple Indices of Credit*

IF the American banker does not care to undertake a detailed analysis of the standing of a foreign country, there are certain simple tests which may be applied in arriving at a quick judgment of the credit position of the nation in question. These tests relate to the budget of the government, the balance of trade and the rate of exchange. The budget shows the amount of revenues and expenditures, and it is important to note whether there is a surplus or a deficit not only in the current year but what has been the trend over a period.

It is also important to inquire into the balance of trade to see whether the country has an excess of exports or imports, and also to what extent such a favorable or unfavorable balance is offset by other items in the balance of payments, such as services or capital movements.

Finally, the state of the budget and the position of the balance of payments directly affect the rate of exchange, and so it is an excellent barometer of the financial condition of a country. A declining exchange rate is often an indication of a weakened credit position of a country, while a rising rate usually signifies that the country's financial position is being considered more favorably in the money markets of the world.

### *Terms of Credit*

AFTER the banker has assured himself that the credit position of a foreign country is sound, the next essential is to ascertain whether or not the particular bond issued by that country possesses characteristics which are satisfactory to him. These relate to place of issue, maturity, security,

and redemption, which will now be considered in order.

Government securities may be either external or internal. With a few rare exceptions the banker should confine his investments to external government securities. While they have no legal priority over internal obligations, nevertheless as a matter of economic policy a government will make every effort possible to pay the interest and principal on its external loans, for it knows full well that a default on these issues will render further borrowing from abroad difficult. Also external loans are usually payable in the stable exchanges. Thus almost all the foreign loans floated in the New York market are payable in dollars, and so the American investor runs no risk of loss through fluctuations in exchange. For the reasons that external loans thus have an economic priority over internals, and are usually payable in better exchange they are safer forms of investment.

The United States throughout its history has followed a policy of paying off its debts whenever the state of the Treasury has justified such contraction. On the other hand, European countries have made little effort to retire their national debts, and so their bonds run to long maturities and in some cases are even in the form of perpetual obligations or "rentes." The shorter the maturity of a bond the less likely it is to fluctuate from the redemption price, and so bonds of this type should be preferred over those of longer maturities.

Government bonds may be either unsecured or secured, or as they are more technically known as "simple" or "reinforced." It is erroneous to conclude that all unsecured loans are unsafe and that secured bonds are necessarily safe. In fact only the stronger governments can borrow on their simple promise to pay. The prospective investor should, however, inquire into the nature of the security behind the bond of a country with a weak credit position. Such security may consist either of a lien or a guaranty. These liens may be based on some form of collateral as the pledge of stocks or bonds which are held in collateral trust for the benefit of the bondholder. Another form of lien is the pledge of public revenues arising from customs duties or from taxes.

From the standpoint of the holder of the bonds, the value of such security depends upon how they are controlled. If they are administered by officials acting in the interests of the bondholders, such pledged revenues may materially raise the value of the bonds of a country with a weak general credit standing. The bonds of a country with more or less doubtful credit may be placed on a sound basis through being guaranteed by another government, whose standing is unquestioned. Thus the guaranty of a group of European nations has converted the Austrian 7 per cent bonds into a security of the highest standing. Guarantees are at times not actual but rather virtual in nature. Thus Holland is indirectly responsible for obligations of the Dutch East Indies, which, therefore, command a high credit position in the international money market. Again, the United States is morally obligated to see that the bonds of Cuba are honored in full, and so these obligations find favor among investors.



Bonds may carry with them sinking fund provisions which tend to redeem these obligations before their maturity. Such provisions usually call for redemption at a price above par, and, if the fund is adequate, its operation tends to sustain the price of the bonds. Sinking fund provisions should, therefore, be noted by investors, as they constitute a certain assurance against wide fluctuations in the price of the bonds.

If these three factors—maturity, security, and redemption—are used as bases for comparison, the bonds issued since 1919 in the New York money market are far more favorable to the investor than those floated in the London and Continental markets in the pre-war period. In other words, bankers freed of the political consideration which often inferfered with the European bankers in past years, have been able to exact safeguards from governmental borrowers which they have granted only because of their inability to obtain money from other sources.

## May Buy Acceptances

ANOTHER development, which promises to afford a broader market for the sale of bankers acceptances, is the recent adoption of an amendment to the laws in New York state, permitting insurance companies operating under its statutes, to purchase these securities. This is expected to enlarge the demand.

## A New Order

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the rules and regulations of this Association as to membership, and they shall be specifically charged with the duty of maintaining and increasing the membership in their states under the supervision of the Membership Committee."

The Council voted to recommend this to the Los Angeles Convention.

The report of the Manager of the Protective Department, James E. Baum, said that the first half of the Association's current fiscal year has witnessed the sharpest reduction in criminal attacks against member banks during any similar period in the history of the Protective Department.

"The advance of organized banking against the criminal is therefore more rapid this year than at any time since 1919, when the present wave of crime began its sweep across the country," he said. "Eighty per cent of the reduction in bank crimes of violence against member banks throughout the country is accounted for in the states where the vigilante plan is used. The results suggest adoption of similar measures by other business associations to supplement and strengthen the arm of the law in an emergency that finds many police forces severely overtaxed. The Protective Committee reiterates its endorsement to the record and possibilities of state police forces and again requests member banks in states without such systems not to overlook the advantages of statewide and state-operated protection, free from political influence.

"With evidence of crime increase about us everywhere, banking should be proud of its rapid progress against the criminal since 1924, but a big job is still ahead of us, and all member banks should continue dealing with the problem thoroughly alive to the fact that crime is strongly organized and better equipped than ever to strike at any opportunity. It cannot be beaten without constant vigilance and the full power of organization."

CHAIRMAN John H. Puelicher, of the Public Education Commission, reporting on its work of fostering among the general public correct habits of thinking about the fundamental principles of banking and economics, told of the rapid expansion of the presentation of talks by bankers and others in the schools and before Young Men's and Young Women's Christian Associations, Lions, Kiwanis, Rotary and other civic clubs, farmers' meetings and a great variety of associations. He reported that 32,000 copies of the talks on banking economics had been distributed. Referring to special states, he said that in Missouri there is a total of 450 workers in the speakers campaign with 61 active county chairmen. California has given 731 talks before over 125,000 people. Oklahoma and North Carolina have greatly increased their activities, while Maine and Vermont are new states listed in the active speaking work. In American Institute of Banking Chapter cities an average of 20 talks in schools and civic clubs were given during the year.

In addition, he pointed out, the broadcasting of the talks by radio had brought millions more as listeners into the scope of the Commission's work.

## *Tax Burden on Banks*

THE report of the Committee on State Taxation, presented by Thornton Cooke, chairman, said the Committee has initiated an exhaustive inquiry into the tax burdens of the banks of the country relaive to those of other taxpayers, so as to ultimately obtain a comprehensive picture of the amount carried by the banks as compared with others in proportion to the respective wealth of each class. "To be of constructive value, investigations should lead to the discovery of general principles," he said. "What does it mean when we learn that the total tax burdens of the United States for the year 1924 was $7,907,000,000? In the first place, there is an increase of nearly $200,000,000 over the year before, although the Federal Government collected $172,000,000 less. State taxation absorbed $186,000,000 more than the year before, and the increase in local taxation was $147,000,000. Federal taxes are only 39 per cent of the total, but

taxes of all kinds take one-eighth of the country's income. It means that we Americans are doing more and more things collectively. There is a feeling that government is costing too much for what we get. We can lay down as one fundamental principle that bankers, with their property so exposed as it is to the tax assessor, should take the lead in investigations looking to the elimination of waste and to the establishment of standards to make public expenditures more wise and more judicious. It is time, too, that bankers should give more thought to the general question: 'What is the best way to raise taxes in American cities and states?'

"Whatever may be the best way to raise taxes, the ad valorem general property tax is not. More and more states are adopting the principle of lower rates for intangible property. Authorities seem to hold that the system is not generally a success in the absence of strong machinery at the state capital, a central authority vigorously enforced over assessments, and over the whole administration of the tax on intangibles. The movement which we have all observed in different parts of the country to separate the sources of state and local revenues holds some hope for the more equal taxation of banks, but only if banks were to be assigned as part of the state's share. If left as a local resource, it is hardly likely that the banks would experience more equitable treatment than now.

"THERE is still to consider the question of state income taxes. The state income tax has on the whole worked well, at least in comparison with preceding forms of taxation, in Wisconsin, New York and Massachusetts. The plan seems not to grow in popularity. However, your committee is convinced that in most states the income taxation of banks and other corporations would be a decided improvement upon the systems now in force. Banks would pay in proportion to their earning power, and the amount of taxation would, on the average, be much less than banks pay now in states where the general property tax is in force. One benefit would be that an income tax would not penalize the provision of large capital for a bank or the building up of a large surplus. The general property tax does involve these penalties. The desire to avoid taxation deemed unequal has kept down the capitalization of banks in general property tax states, and cannot have failed to have had something to do with the multitude of bank failures.

"In Massachusetts, banks paid an ad valorem tax which amounted to 30 per cent of their income. Under the income tax law they pay 6 per cent of their net income. New York banks were so desirous of going upon an income tax basis that this Committee, meeting with the Special Committee on Taxation, recommended legislation, since adopted, which has made it possible for the New York legislature to adopt the system desired by the bankers.

"Your Committee desires, therefore, to make a definite recommendation, based upon careful study of state taxation systems that, in states where bank shares are now subjected to an ad valorem tax, bankers give earnest consideration to the question of working for a change to net income as the basis of bank and other corporation taxes. If this were to do away with the General Property Tax altogether, so much the better. The inconsistencies an injustice of taxation in that form have long enough been an incitement to evasion, a penalty for success and a brake on progress. The change to an income basis accomplished, bank taxes will probably be less and certainly more equal."

THE report of the Special Committee on taxation, presented by Elmer A. Onthank, said the committee exists for the special purpose of safeguarding from hostile amendment Section 5219, United States Revised Statutes relating to State taxation of national banks. The report said this section permitted the states to tax the income of national banks or the dividends of the shareholders as alternatives to taxation of the shares. In New York, the banks desired to be taxed on their income on a basis of equality with other corporations, and the Legislature was willing to so provide, but found it impracticable because taxation of the income of corporations was in the form of a franchise tax which enabled the state to include tax-exempt securities. This inclusion could not be made in the case of national banks. Also shareholders of New York corporations were obligated to include their dividends in their personal income tax, and Section 5219 would not permit the taxation of dividends.

New York bankers presented the situation to the Special Committee and to the Committee on State Taxation of the Association. This resulted in a committee being appointed to confer with one from the National Tax Association to further amendments of Section 5219. Amendments were finally agreed upon, passed Congress and the bill was signed by the President.

The efforts of the committees representing the Association thus resulted successfully, and the way is now open to a number of states to abandon the property tax upon shares and substitute a system of income taxation on a basis of equality with other business corporations. Since the amendment of the law the State of New York passed a law under which banks will be placed on a 4½ per cent income tax basis, the same as is now imposed upon business corporations and the share tax and moneyed capital tax have been repealed, the report said.